The Economist
The danger of Dean
PAGES 12 AND 27
America's business recovery
PAGES 11 AND 63-66
After Japan's election
PAGES 10 AND 23-25
Is China overheating?
PAGE 67
NOVEMBER 15TH-21ST 2003
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Full contents
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POLITICS THIS WEEK

BUSINESS THIS WEEK

OPINION
Leaders
Letters

WORLD
United States
The Americas
Asia
Middle East & Africa
Europe
Britain
Country Briefings
Cities Guide

SURVEYS

BUSINESS
Management Reading
Business Education
Executive Dialogue

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Economics Focus
Economics A-Z

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Technology Quarterly

PEOPLE
Obituary

BOOKS & ARTS
Style Guide

MARKETS & DATA
Weekly Indicators
Currencies
Big Mac Index

DIVERSIONS

RESEARCH TOOLS

CLASSIFIEDS

DELIVERY OPTIONS
E-mail Newsletters
Mobile Edition
RSS Feeds

ONLINE FEATURES
Cities Guide Go
Country Briefings Go
Audio interviews Go
Classifieds Go

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Print Edition November 15th 2003

They say we're getting a democracy
How America should promote its values in the Arab world, and how it shouldn't ... More on this week's lead article

The world this week

Politics this week
Business this week

Leaders

Democracy and the Arabs
They say we're getting a democracy

Japan's election
Bad for Koizumi, good for Japan

British justice
Who judges the judges?

Surviving better times
Keep calm, stay focused

American politics
Howard the duck

Letters

On Bulgaria, protecting rights, Terri Schiavo, corporate governance, Freddie Mac and Fannie Mae, chickens

Special Report

Japan's election
Intimations of a sunrise

United States

Howard Dean
The doctor is in (the driving seat)

The economy, jobs and steel
Hard decisions

Judicial nominations
Waiting for Godot

The diner rolls on
Burger's revenge

Mental illness
Locked up

The Supreme Court and Guantánamo Bay
Help from above

Lexington
Arnold the bipartisan

Award: legalising drugs

The Americas

A rising star in Mexico
The man who would be president

Colombia's government
Falling back on friends

Canada's defence policy
On the cheap

Chile's right-wing opposition
Loveless relationships

Asia

Politics in China
Gate-crashing the party

The Afghan economy
It's hard going straight

Sri Lanka
The smile on the face of the Tiger

Middle East & Africa

Saudi Arabia
How safe is the House of Saud?

Iran's nuclear ambitions
Seen through?

Previous print editions
Nov 8th 2003
Nov 1st 2003
Oct 25th 2003
Oct 18th 2003
Oct 11th 2003
More print editions and covers »

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Business

Trade wars
Sparks fly over steel

Music mergers
Come together

Antitrust and Microsoft
Windows of opportunity

Mergers and acquisitions
The dominator

Telecoms and airlines
Parallel lines

Auction houses
Going

Executive coaching
Corporate therapy

Face value
The one-handed economist

Award: Iain Carson

Correction: Honeywell

Special Report

America's business recovery
Time to get this show back on the road

Finance & Economics

China's economy
Steaming

American futures exchanges
The front line of futures

American stock exchanges
Printing money

Accountancy and law
Back to basics

Financial reform in Japan
Friendless

Insurance and gender
The price of equality

Swiss private banks
Abroad thoughts from home

Economics focus
God, man and growth

Science & Technology

Memory and emotion
Thanks for no memory

Treating arthritis
Leeching away pain

Gamma-ray bursts
Bursting with controversy

More on gamma-ray bursts
Perishing publishing

Books & Arts

Israel and Palestine
A senseless spiral

British prisons
Rambo's lament

David Sylvester

America's Iraqi ambitions
There must be some way out

Congo
Not as bad as dad

Namibia
For whom the builders toil

Europe

European economies
A hitch to recovery

Italian politics after Nasiriya
The opposition finds its man

Germany's far right
Raus

Nordic alcohol policies
Viking binge

French corruption
Elfs and dwarfs

Russia's need to belong
Seal of disapproval

Lithuania's embattled president
Dropping the pilot

Charlemagne
Europe's rebellious regions

Britain

Police reform
Hard to turn the coppers round

Business gripes (1): regulation
Red tape, blue moods

Business gripes (2): tax
Tax tussles

Transsexuals
Right cross

The economy
Higher growth, higher rates

Scottish economy
Piped lament

The Conservative Party
Team Howard

Judges
Bench press

Bagehot
It's personal

Articles flagged with this icon are printed only in the British edition of *The Economist*

The eyes have it

European history
Better luck next century

Native Americans
The price of intercourse

Philosophy lessons
Head jam

Obituary

Richard Neustadt

Economic and Financial Indicators

Overview

Output, demand and jobs

Prices and wages

Austria

Money and interest rates

The Economist commodity price index

Stockmarkets

Trade, exchange rates and budgets

Exchange-rate forecasts

Emerging-Market Indicators

Overview

Political and economic stability

Economy

Financial markets

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Politics this week

Nov 13th 2003
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Bombs in the Middle East

AP

A suicide attack on the headquarters of the Italian military police in the southern **Iraqi** city of Nasiriya, killed at least 27 people. America's administrator in Iraq, Paul Bremer, flew to Washington for talks on how to accelerate the transfer of power to Iraqis. After the Nasiriya blast, Japan said conditions were not right for it to send promised troops.

See article: A bloodied kingdom

Suicide bombers killed at least 18 people at a residential compound, housing mostly Arab expatriates, in **Saudi Arabia's** capital, Riyadh. Saudi and American officials blamed al-Qaeda.

See article: Bombs and reform in Saudi Arabia

The **Palestinian** parliament approved the new government of the prime minister, Ahmed Qurei. He called for a ceasefire with Israel and an international peace conference.

Iran reportedly admitted to the United Nations' nuclear watchdog, the International Atomic Energy Agency, that it had produced plutonium—a material that could be used in nuclear weapons. A leaked report from the agency offers no “direct” evidence of a weapons programme but ample evidence of Iranian lying. Iran said it would suspend uranium enrichment and will allow tougher UN inspections of its nuclear facilities.

See article: Judging Iran's nuclear ambitions

Zambia's former president, Frederick Chiluba, pleaded “not guilty” to 169 counts of theft of public funds totalling $30m—equal to three days' income for every Zambian.

Zimbabwe's first president, Canaan Banana, who was the country's non-executive head of state from 1980 until 1987, died after a long illness. He was 67.

Terror on trial

America's **Supreme Court** said that it would hear a case brought on behalf of foreign terrorist suspects held at Guantánamo Bay. It will decide whether America's civilian courts have jurisdiction over the prisoners, who are held currently as “enemy combatants”.

See article: The Supreme Court wades into Guant

In an increasingly bitter row the Senate spent an all-night session debating who was to blame for blocking President George Bush's **judicial nominees**. Republicans, who control the chamber, were not able to muster enough votes to stop Democrat “filibusters”. The confirmation of several conservative judges to the Court of Appeals was stalled.

See article: Judges to be questioned

Jessica Lynch, an American soldier held briefly by the Iraqis, said she was

AP

upset by the Pentagon's exaggerated account of her capture and rescue during the war. Ms Lynch said she was grateful to her saviours but that she had played no heroic role in her liberation.

Roy Moore, Alabama's chief justice, went before a judicial panel. It will decide if Mr Moore should lose his job for defying an order to remove a monument to the **Ten Commandments** from the state courthouse.

George Soros, one of the world's richest men, confessed that ending the presidency of Mr Bush was now “the central focus of my life”. Mr Soros, whose foundations have spent around $5 billion promoting democracy around the world, has given $15m to organisations campaigning against Mr Bush in next year's election.

A hint of change?

The governing Liberal Democratic Party of prime minister Junichiro Koizumi and its coalition partners held on to power in parliamentary elections in **Japan**. But big gains by the opposition Democratic Party could help lead the country toward a real two-party system.

See article: How will Japan's election affect reform?

A car bomb exploded outside a UN office in the southern **Afghan** city of Kandahar. Two people were wounded in the blast.

China announced a new drive to reform its state-owned enterprises. It will speed up the sale of assets to foreign and private companies over the next two years to reduce in size the state-owned sector of the economy.

See article: Is China's economy overheating?

Sri Lanka's president and prime minister held talks in an attempt to ease the country's constitutional crisis. The meeting comes after the president fired top ministers and suspended parliament last week.

See article: Sri Lanka's political crisis

Georgian features

Thousands of protesters took to the streets of Tbilisi, demanding that **Georgia's** president, Edward Shevardnadze, annul recent fraud-ridden parliamentary elections. Mr Shevardnadze is under pressure to resign; he has, rather ominously, been promised support by Russia.

A **Moscow** court turned down a request for bail put by Mikhail Khodorkovsky. The ex-boss of the Yukos oil giant faces tax evasion and fraud charges. The prosecutor suggested that he might stay in jail for as long as two years while the case against him was assembled.

AP

See article: Russia's efforts to join western clubs go awry

Three former executives of the **French** state-owned oil giant, Elf, were given long prison sentences for corruption and embezzling funds for their personal use.

See article: The last verdict in the Elf trials

Lithuania's president, Rolandas Paksas, resisted demands for his resignation after an official report criticised links between some of his advisers and Russian gangsters. But many expect him to go soon.

See article: Rolandas Paksas is under growing pressure to quit

Colombia's reshuffle

Stung by the failure of a referendum on fiscal reform, Álvaro Uribe, **Colombia's** president, sacked his controversial interior minister and his effective defence minister. He appointed two businessmen in their place. The military and police commanders went, too.

See article: Colombia's Uribe shuffles his government

In a record turn-out, voters in **Guatemala** snubbed a presidential bid by Efraín Ríos Montt, a former dictator. The presidency will be decided in a run-off next month between Óscar Berger, from a conservative business-backed party, and Álvaro Colom, who heads a centre-left coalition.

Reuters

Eight people were killed in clashes with troops during a one-day general strike in the **Dominican Republic** in protest at austerity measures being negotiated between the government and the IMF. The country's second-largest bank collapsed in April, sending the economy into chaos.

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Business this week

Nov 13th 2003
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Trade politics

Transatlantic **trading relations** are set to sour after the World Trade Organisation ruled that tariffs on imported steel imposed by America last year are illegal. The European Union may now retaliate with tariffs of up to 30% on American imports worth some $2.2 billion. The products, ranging from sun glasses to luxury yachts, were exquisitely chosen to inflict maximum political pain on George Bush. Japan, Brazil and other affected countries promised similar measures.

See article: Trade wars over steel

Landing in it

Michael O'Leary, boss of **Ryanair**, revealed that the European Commission was set to rule that his low-cost airline had received illegal state-aid from Belgium's Charleroi airport. Mr O'Leary said that he would appeal against the decision once it is made public. The ruling could force Ryanair out of Charleroi and expose to legal challenge similar deals with other publicly owned European airports.

British Airways reported a sharp fall in first-half pre-tax profits of 57% compared with a year ago to £105m ($169m). Lord Marshall announced his retirement as chairman of that troubled airline. BA confirmed that Martin Broughton, currently chief executive of BAT, would take over the chairman's role.

Lufthansa announced an operating profit of *euro*200m ($225m) in the third quarter and cheered investors by saying that it expected to break even over the year, after deep cuts to jobs and routes.

See article: Telecoms and airlines

Bayer beware

Bayer announced a third-quarter loss of *euro*123m ($138m) but unveiled plans to revamp its ailing business. The German drug giant will spin off its chemicals business and reduce operations in America.

American scientists led by Craig Venter, who also headed a privately funded team that sequenced the human genome, announced the first completely **artificial synthesis** of an organism's genome. The result, a virus called Phi-X174, was able to infect bacterial cells and then reproduce inside them exactly like a natural virus.

The European Commission began hearings on whether **Microsoft** has abused the dominant position of its PC operating systems. The software giant could face a huge fine and may be forced to reveal more of its software code to competitors.

See article: Microsoft on trial

Ford's credit rating was lowered by a notch, leaving the struggling car company's bonds just one downgrade away from junk status. Standard & Poor's said the move reflected Ford's poor profitability; the car firm replied that the rating was unfair.

Another week, another music merger. Last week **Sony Music**, the world's second-largest music

company, announced plans for a merger with the music unit of Germany's **Bertelsmann**. This week **Universal Music**, the world's leading music group, agreed to buy the music arm of **DreamWorks** for a reported $100m.

See article: Music marriages of necessity

Ahold crept back into profit in the first half of this year, making *euro*60m ($66m). The Dutch firm hopes to retain its place as the world's third-largest retailer with a rights issue that will raise around *euro*2.5 billion and divestments that will bring in a similar amount. The cash will help to repair its balance sheet and put behind it a huge accounting scandal that hit profits last year.

Mutual disrespect

Investors withdrew a staggering $14 billion from **Putnam Investments**, recently charged in connection with America's spreading mutual-fund trading scandal. However, Americans deposited $24.5 billion in mutual funds in October, the highest monthly sum for a year and a half.

Alliance Capital Management, one of America's largest money managers, ousted two executives after it came under scrutiny for the improper trading of mutual funds.

British regulators also began a probe into the improper trading of mutual funds; shortly afterwards Germany followed suit. In an effort to avert a crisis similar to America's, regulators in both countries have asked fund managers if they have come across instances of unfair trading practices.

Bear behind

UBS made a bumper profit in the third quarter of SFr1.7 billion ($1.2 billion), 78% more than a year ago. Switzerland's leading bank did well in all areas of business. “The bear market is over,” declared Peter Wuffli, UBS's chief executive.

Commerzbank announced a loss of *euro*2.3 billion ($2.6 billion) in the third quarter, after writing down assets. The German bank revalued its securities and investments portfolio to “fair value”. Speculation mounted that the bank was preparing itself for takeover.

Back on track

Europe's economies improved after a bad spell. France's economy grew at an annual rate of 1.6% in the third quarter compared with the previous quarter; Germany's expanded by 0.9% in the same period. However, neither of the big European economies could match America's recovery, its economy grew by 7.2% according to recent figures.

See article: The slow but steady recovery of Europe's economies

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Democracy and the Arabs

They say we're getting a democracy

Nov 13th 2003
From The Economist print edition

How America should promote its values in the Arab world, and how it shouldn't

Reuters

IN WASHINGTON on November 6th George Bush made an excellent speech in which he said that Arabs were no less capable than other people of enjoying democracy and that helping them to do so should and would be part of American policy for decades to come. Following the excellent speech, events on the ground continued in their dismal pattern. Suicide bombers presumed to be from al-Qaeda struck in the heart of Riyadh, Saudi Arabia's capital. In Iraq guerrillas killed more American soldiers and blew up an Italian police headquarters. How worrying is this apparent disconnection between the lofty speechifying from Washington and what is actually happening in the Middle East?

The first point to make is that although a speech is just a speech, some things need to be said out loud, even if you might think they go without saying. Usually, they don't. Indeed, the Arabs' British and French colonisers seldom took the view that Arabs were fit for democracy. It is after all less than a dozen years since France quietly encouraged Algeria's army to cancel an election the Islamist opposition was poised to win in the former French colony. That calamitous mistake led to a civil war costing perhaps 100,000 lives. And there are still many people—both Arabs (usually the ones in power) and observers of Arabs—who invoke religion, culture and a medley of other excuses in order to argue that the Arab world is uniquely unsuited to democracy. So now that the collapse of the Soviet Union and the occupation of Iraq have made America the dominating outside power in the region, it is no bad thing for an American president to declare that he believes none of the excuses. Having the power to hire and fire your government is a simple idea that most Arabs both understand and, according to opinion surveys, want for themselves.

Speak loudly, but keep your stick at home

Now that he has stated his belief in democracy, however, Mr Bush cannot simply confer its blessings on the Arabs with the wave of a wand. Nor should he heed those voices at home that urge him to do so by using instruments more substantial than a wand, such as political or economic sanctions, or—heaven forbid—pro-democracy “regime change” enforced, as in Iraq, by American military power.

To be sure, those who advocate this course of action have an interesting case to make. Since the September 11th attacks, they argue, it should be clear that the absence of democracy is one of the things that turn Arabs towards Islamic extremism and against an America widely seen as the propper-up

of repressive regimes. This argument is probably right. So is its corollary that the creation of a liberal, democratic order in the Arab world is in America's own long-term interest. But there is a fine distinction—and a world of difference—between a policy of advocating democracy and a policy of imposing it. Apart from being questionable in principle (what gives America the right to force its choices on others?) any crude attempt to impose democracy on the Arabs is liable to backfire in practice.

One way such a policy could backfire is by knocking over bad regimes only to see even worse ones take their place. The existence of a general Arab appetite for democracy does not mean that the alternative to a repressive, authoritarian regime is bound in every case to be a liberal democracy. Far from it: in Saudi Arabia, to judge by al-Qaeda's extensive underground network there (see article), the fall of the conservative Islamists of the House of Saud could very well clear the way for the rise of a reactionary Islamist regime of the very sort favoured by Osama bin Laden. And even in Arab countries that have a more sophisticated, secular style of (non-democratic) politics—Egypt and Syria, say—any kind of regime change that is construed locally as an American initiative is in danger of stoking up so much nationalist or Islamist resentment that it alienates more people than it wins over. In promoting democracy in the Arab world, Mr Bush should never forget the physicians' maxim: first do no harm.

To would-be Arab democrats, of course, an America that claims to champion democracy while remaining the protector and paymaster of authoritarian regimes runs the risk of looking hypocritical. The superpower's credibility among Arabs is anyway already close to bottom by virtue of its alliance to Israel and the non-discovery in Iraq of the banned weapons on which it based most of its case against Saddam Hussein. Nonetheless, in between the two extremes of doing nothing and pulling the plug on unlovely regimes there exists a range of middle options. Advocacy (“lip service”, to its detractors) has a certain value in itself. And there are umpteen other ways in which America could use its money and influence to prod regional allies towards political reform without tipping them into collapse. For example, the American taxpayers who fork out $4 billion-plus every year in aid for Israel and Egypt are entitled to expect a more receptive attitude to Palestinian statehood from the former, and to democracy from the latter.

Beyond this Mr Bush faces, in Iraq, a far more urgent test of his belief in the possibility of Arab democracy. This is not a place Mr Bush invaded for democracy's sake (though some American “neoconservatives” argued that this should have been a central aim). The main reason he gave, and what made the invasion right, was the threat of a Saddam armed with weapons of mass destruction. But now that it is in Iraq, interest and obligation alike require America to make sure that it transfers power to some form of Arab democracy.

This is a tall order. The price of failure could be high. Without a transition to democracy, the likelihood is that Iraq will remain permanently occupied, or degenerate into another terror-breeding failed state, or fall under the control of a new dictatorship no better than the old one. Any of these outcomes would be disastrous for America's interests and reputation. Success, on the other hand, could bring immense rewards: not just a stable Iraq but a worked example of an Arab democracy which millions of other Arabs might then come to admire and emulate of their own accord. That is why Mr Bush is right to accelerate the transfer of power, but also why he must not bodge it. More is at stake than Iraq alone.

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Japan's election

Bad for Koizumi, good for Japan

Nov 13th 2003
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The country needs a lot more competition, at every level

Reuters

THERE are probably as many explanations for what lies at the root of Japan's prolonged economic stagnation as there are canonical views of Mount Fuji—of which the wood-block artist Hokusai (1760-1849) first found 36 and then 100. Some schools of thought blame the central bank and its failure to tackle deflation speedily after the asset-price crash began in 1990. Others blame the commercial banks for failing to get tough with bad debtors; or the ruling Liberal Democratic Party (LDP) for being too cosy with the banks and the debtors both; or rigidities in the labour, employment or pretty much any other market. All these explanations, though, are rooted in a single big one: a lack of competition, in everything from political ideas to the supply of *shiitake* mushrooms. On November 9th, Japan got a big injection of the competition that does most to drive progress in most other countries. Its general election may for the first time have turned Japan into a genuine two-party state. The consequences, psychological as well as practical, should be momentous.

Since General MacArthur imposed democracy on Japan, elections there have been a yawn. Except for an eight-month period in 1993-94, the LDP has ruled ever since it was created, in 1955. For decades, the battle for power has been conducted not in parliament or on the hustings, but in secretive tussles between obscure rival factions of the party, over which the Japanese voter had little more say than a Chinese factory-worker has over the membership of China's Politburo. There were plenty of opposition parties, to be sure: but they split each other's votes and feuded incessantly. In this atmosphere, unhealthy alliances between politicians, banks, bureaucrats and big business flourished unchallenged, and the lack of competition at the top has filtered down to every level. Hence the rules that make it so hard for foreign firms to buy Japanese ones, and the way newspapers all take their holidays on the same day. Even when the LDP throws up a would-be reformer, such as the current prime minister, Junichiro Koizumi, the cosy alliances conspire to frustrate him. Mr Koizumi's two years in office have seen much talk of change, but little progress, largely thanks to obstruction from within his own party.

It is far too soon to say that this has changed for good, but the signs are encouraging. In the election last weekend (see article), support for the opposition Democratic Party of Japan (DPJ) surged, taking it from 137 to 177 seats in the 480-member Diet. Interestingly, its gains were more at the expense of smaller opposition parties, such as the unlamented Communists, whose representation was halved, than of the LDP. The Japanese opposition voter, it seems, has at last worked out that a vote for the far left in fact helps the right, and so has voted instead for consolidation. The two big parties between them now control 87% of parliament's seats. Two medium-sized parties, the Liberals and now the New Conservatives, have been absorbed in the past two months.

This sets the stage for genuine competition between two relatively equal, electable parties. To a large extent, it has already started. The DPJ made political history in Japan by putting forward a detailed manifesto for this election, which was countered by a similar, though woollier, document from the prime minister. In lots of heartening ways, the thrust of the DPJ manifesto was reformist—though it had little to say about some of Japan's worst problems, especially its mountain of non-performing loans. But it attacked the granting of lavish subsidies to agriculture, the concreting-over of much of Japan in unproductive public-works schemes that benefit building firms but no one else, and the slanting of aid towards the LDP's friends. In a proposal that would do more for competition than almost anything else could, it pledged to decentralise power—and tax revenues—to Japan's provinces, which might then drive the country through a virtuous cycle of competition about what to deregulate, and when.

Courage, Koizumi

Paradoxically, then, Japan's election, despite being bad for Mr Koizumi personally (his party lost ten seats even though the LDP's previous performance, in 2000, had itself been viewed as a disaster) could on balance be good for reform. Naturally, the party's old guard is already arguing that by boosting rather than cutting spending, a better result could have been achieved. But Mr Koizumi is still an asset to his party, and with the opposition now snapping at its heels the LDP is less likely than ever to replace him, if only he is brave enough to call the old guard's bluff. The main point is that a severe contest in political ideas has been started, and will not easily go away.

Mr Koizumi's task is to harness Japan's new receptiveness to competition and apply it to the economy. He has often spoken of the need for “reform with no sacred cows”, but he needs to act on that. That means more privatisation, for a start. He has long talked of the need to sell off Japan's ruinous Highway Corporations: now that the DPJ has committed itself to doing the same, he has no more excuse for delay. Likewise with the postal savings system, a tried and tested method of funnelling taxpayers' money to bad causes. “Zombie” companies, ones that would long ago have gone under if the banks were compelled to be less indulgent towards non-performing loans, need to be put out of their misery. That will mean job losses, it is true. But the zombies, the beneficiaries of uncompetitive advantages, are starving sprightlier prospects of the resources they need. Shopkeepers, utilities and farmers all need to feel the winds of competition too. Competition will be painful. But at the moment Japan is feeling plenty of pain anyway, without the gain competition would bring.

It might have been better for Japan had the DPJ won on November 9th, though doubts must remain about the cohesiveness of a young party that has only just absorbed the Liberals. As it is, an invigorated opposition will be able to keep the LDP up to the mark in the run-up to elections to Japan's powerful upper house, due in July. If he is brave, and if the opposition is responsible enough to support those policies that it agrees with, Mr Koizumi has a chance to start doing what he has always promised—to change Japan for good.

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British justice

Who judges the judges?

Nov 13th 2003
From The Economist print edition

Britain's judges are right to complain about planned reforms—but are exaggerating their case

Reuters

SITTING on the Woolsack resplendent in his wig, gaiters and buckles, the Lord Chancellor is a throwback to Britain's feudal past. It looks indefensible: a senior member of the executive branch exercising virtually unchallenged powers over the judiciary. Yet as Tony Blair's government has found with its deeply unsatisfactory reform of the House of Lords, chipping bits off Britain's ramshackle, unwritten constitution is easy. Replacing them is more difficult.

The government's consultation paper on abolishing the Lord Chancellor, misleadingly titled, in Whitehall double-speak: “Reforming the office of Lord Chancellor”, has infuriated senior judges. The Lord Chief Justice, Lord Woolf, said the threat to the judiciary's independence bore comparison with the political turmoil of the 17th century, when rebellious judges were executed. His deputy went even further, invoking the spectre of Nazi Germany.

Such language verges on the silly. But the judges have reason to be both cross and anxious. They were neither consulted, nor given warning when the abolition of the Lord Chancellor was casually announced as a by-product of the prime minister's botched shuffle of his government this summer. Its far-reaching consequences were not thought through. Moreover, the worsening mood between judges and politicians pre-dates this. The home secretary, David Blunkett, has alienated almost the entire legal profession with his populist approach to justice and his public attacks on verdicts.

Despite that harmful background, however, the government's proposals should be examined on their merits. The independence of the judiciary depends on the way judges are selected. The government's preferred solution is for an appointments commission, itself chosen by an independent body, to select judges, subject only to a ministerial veto on individual appointments which would have to be defended publicly. Lord Falconer, the secretary of state for constitutional affairs, believes (see article) that such a power is needed to preserve accountability. He should think again. The reasons for a ministerial veto could not be made fully transparent without grave harm to the reputation of individuals. And even the hint of ministerial interference would serve to undermine the judiciary's independence.

Much better would be for ministers to make their reservations about a particular candidate known directly to the appointments commission. It could then either endorse or reject them. The judges also object to the government's proposal to enshrine in legislation the criteria for judicial appointments. The Judges' Council claims that this would enable a future government to create a judiciary sympathetic to its own agenda by manipulating the selection criteria. But here the judges are almost certainly protesting too

much. It is highly unlikely that such party-political interference would ever be endorsed by Parliament or accepted by an independently chosen appointments commission.

Other jurisdictions, notably America's Supreme Court, have an openly political approach to judicial appointments. But the checks and balances in a congressional system with a written constitution are different. In Britain, an independent judiciary is an essential safeguard, especially at a time when a government in command of a huge parliamentary majority means that often the only effective check on ministers is judicial review. That safeguard needs to be protected.

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Surviving better times

Keep calm, stay focused

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From The Economist print edition

How American companies should regard the upturn

JUST when American companies had cut every cost they could think of, the economy has begun an indisputable recovery. In the third quarter, the American economy grew at the fastest annual rate for 20 years. A hefty tax cut, a public-spending splurge, a declining dollar, consumers borrowing cheap money like crazy: all have played a part. But so has the business cycle, which dictates that investment and inventories will, sooner or later, stop falling and start to recover. Another key factor has been the remarkable speed with which American businesses have responded to the downturn (see article). Both the business cycle and corporate flexibility make it more likely that, if the pace of the current recovery falters, there will not be a renewed slump. The question facing managers now is: how should they make best use of the revival?

Some of the themes are already emerging. Many American firms have clearly decided to be cautious about rehiring workers. New jobs always pick up more slowly than the economy as a whole, but in this upturn, employment growth has been unusually tardy and hesitant, even if that growth does now seem to have begun (see article). American companies showed a much faster and more decisive response to the downturn than those in any other country, an advantage conferred by the country's extraordinarily unfettered labour market. And yet the unpleasantness of sacking thousands of people has also made managers understandably reluctant to take on new staff. In addition, whereas the prices of many products are falling, workers grow ever more costly. Pay may not be rising rapidly, but the costs of health care and pensions are.

In the effort to cut headcounts, companies have learned two lessons, one old, the other new. The old lesson is the need for attention to detail and delivery. “Execution, execution, execution” has been the mantra of the past two years, as companies have turned their backs on strategy and vision, and instead concentrated on making sure that the corporate engine-room runs smoothly and frugally.

The new discovery is that the information technology in which so much was invested can really make a difference. As always, too much was expected in the short run and not enough in the long term. Now, America's astonishing advances in productivity seem to be at least partly the result of a sweeping overhaul of business processes needed to make the most of computers and related technology. Dell Computer, as so often in the recent past, has been a pioneer. By renegotiating deals with suppliers, redesigning inventory management and installing new software, the company increased by a quarter the capacity of one of its plants. That allowed it to expand output without constructing new physical plant: in effect, to build a virtual factory. Learning to make the most of new technology in this way always takes time, and is a complex task, but many companies are now entering the recovery with a much greater understanding of what needs to be done than when the downturn began.

Now, balance sheets and budgets

As American companies once more start to grow, the searing experiences of recent years will keep them cautious—more cautious than financial analysts, who still dream foolishly of returning to durable double-digit earnings growth. In fact, many firms still have a long way to go to repair their ravaged balance sheets. They would be wise to grab the chance to do so now, before interest rates start their inevitable upswing.

In addition, companies need to retain the low-cost, high-productivity culture of the past two years. Like someone on a diet who finds that pounds fall away unexpectedly fast, firms still need to stay off the chocolate cake and carry on with the rowing machine.

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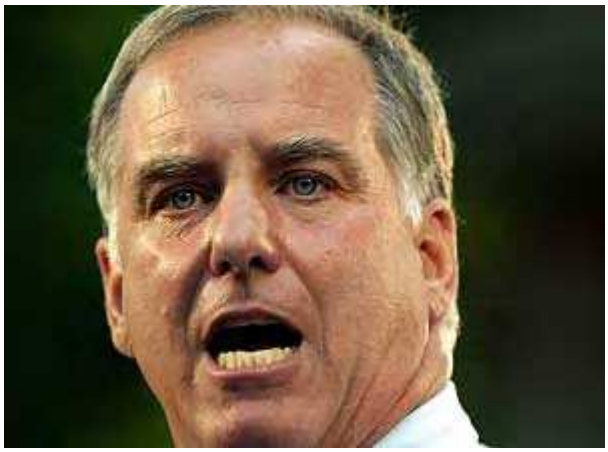
American politics

Howard the duck

Nov 13th 2003
From The Economist print edition

Unless he changes course dramatically, Dr Dean looks the wrong man for the Democrats

Getty



THE New Hampshire primary may still be two months away, but this week Howard Dean drew considerably closer to winning the Democratic nomination to take on George Bush in next year's presidential election. First, in an impressive display of strength, he announced that, like Mr Bush, he would forgo receiving federal electoral money, because it comes with limitations on what a candidate can spend. Then he picked up the endorsements of two big unions. Add Dr Dean's considerable lead in the polls in New Hampshire, and he is the clear favourite (see article).

“The Dean insurgency” is already a remarkable story. Eschewing better-known Washington types, such as Senators John Kerry, Joe Lieberman and John Edwards, and Congressman Dick Gephardt, keen activists have flocked to the standard of the fiery former governor of Vermont, the only candidate to condemn the Iraq war unambiguously. Dr Dean has pioneered a new form of internet campaigning (he even used it to consult his supporters about whether he should forgo federal funds). But the root of his appeal is that he represents “the Democratic wing of the Democratic Party”—the rank-and-file who loathe Mr Bush and the Quisling Democrats.

Is this insurgency charging in the right direction? Begin with the assumption that Mr Bush does deserve a lot of tough questioning. America's economic woes may not really be his fault: blame that on the bubble built up in the Clinton years. But by cuddling up to industry lobbies and failing to keep any control on spending (and not just of the defence sort), the president has turned a huge budget surplus into a large deficit. In many eyes, he has needlessly trampled on civil liberties at home, made a hash of governing Iraq and the Middle East peace process, and, in the battle against terror, has wasted the goodwill towards America that foreigners used to feel—something that next week's huge demonstrations in London will underline. A man who came to office as a compassionate conservative has generally ruled as tough right-winger.

From this perspective, a centrist New Democrat—similar to Bill Clinton in 1992—would be a formidable foe. Dr Dean, alas, seems to be heading in anything but a centrist direction. It is not just his opposition to a war which a slight majority of Americans still think was a good thing. Egged on by his mad-as-hell supporters, he has lurched to the left, denouncing the North American Free-Trade Agreement and promising to repeal all Mr Bush's tax cuts, not just those for the rich. Already Democratic moderates have begun to hark back to George McGovern, the party's candidate in 1972, whose fierce opposition to the Vietnam war went down well with Democratic enthusiasts, but who was thrashed by Richard Nixon.

Need it be that dismal? Dr Dean was actually a surprisingly moderate governor of Vermont, balancing the budget and backing conservative causes such as gun rights. Democratic optimists claim that his current extremism is similar to Mr Bush's pandering to the right during the 2000 primaries. But there is a difference: Mr Bush was first presented to the nation as a compassionate conservative, so it was easy for him to tack back to that stance. Dr Dean has appeared on the nation's television sets with all the moderation of a howling dervish. Clawing his way back to the centre, even if he were to select General Wesley Clark as his running-mate, would be hard.

One problem for the Democrats is that they are not blessed with strong alternatives. Early enthusiasm for Mr Clark has faded, Mr Kerry has just sacked his campaign manager, Mr Lieberman is struggling, Mr Edwards seems inexperienced. But if they really want to depose Mr Bush, either the Democrats or Dr Dean will have to change course—and fast.

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Letters

Nov 13th 2003
From The Economist print edition

The Economist, 25 St James's Street, London SW1A 1HG
FAX: 020 7839 2968 E-MAIL: letters@economist.com

Simeon says...

SIR – I welcome your positive statements about Bulgaria and the role played by my government in preparing for our accession to the European Union ("In the waiting room", November 1st). However, there are a few matters on which your comments are ill-founded.

I did not promise "to solve all [my] country's problems in 800 days." This is a substantial embellishment of what I actually said in a speech in April 2001. The results of the local elections, completed on November 2nd, represent a satisfactory balance for the ruling coalition, especially when you consider that the National Movement Simeon-II is a totally new party with a modern approach and none of the baggage carried at grass-roots level by the others.

The achievements of the government I lead are already self-evident. You mention several. I would add another: a reduction in unemployment by five percentage points since we took office. We are running the country in a new style and with a strong team. I have had numerous poison arrows directed towards me but few can be wider of the mark than the suggestion that I exercise power "in a relatively innocuous manner".

Simeon Saxe-Coburg
Prime minister
Sofia

Limited rights

SIR – Although freedoms and liberties are to be treasured they must also be protected, and not only by the courts, as Harold Hongju Koh implies (By invitation, November 1st). Terrorism poses a serious threat to these rights and religious fanatics pose novel challenges. Conventional arrest and prosecution is advocated but the International Criminal Court is of little use against suicide attackers. The United Nations is offered as a solution, although many of its member countries still host groups advocating hatred of America and promoting terrorist action.

New approaches must be considered. Far more constructive was Robert Bork's testimony, during his ill-fated confirmation hearing for America's Supreme Court. He believes there is a limited pool of rights and that one group must surrender some in order for another group to gain some. Contemplation and intelligent discussion of the issue of freedoms and liberties is best served by such input.

Jerome Hartke
Sudbury, Massachusetts

Right to life

SIR – Terri Schiavo's case is not about a right to die ("Whose life is it, anyway?", November 1st). Mrs Schiavo does not suffer from a terminal illness. She is not kept alive through extraordinary medical means; she is merely given food and water that she cannot swallow on her own. There is no legal right to suicide nor do family members have a right to kill inconvenient imbeciles. We do not permit prisoners on hunger strike to refuse sustenance, nor parents of mentally impaired children to commit infanticide. How is Mrs Schiavo's case different?

Dylan Alexander
Houston

Getting on board

SIR – I would caution the assumption in your survey of corporate leadership that the greater involvement of shareholders in corporate governance is some sort of panacea (October 25th). On the contrary, research by Bain & Company shows that the disconnection of objectives between shareholders and the companies they invest in has never been higher.

There is an increasing number of investors—day traders, short-sellers, arbitrageurs, hedge funds, single-issue shareowners, passive index trackers, etc—who have no incentive to concern themselves constructively with issues of governance and long-term value creation. Even so-called “active investors” frequently have corporate-governance staff who have minimal experience of business or boardrooms. Indeed, their views seem mostly irrelevant to the investment decisions of their own fund managers. Furthermore, the governance and performance of many, though not all, institutional investors leaves a great deal to be desired.

The solution to corporate-governance problems is for investors, regulators, politicians and media to complain and challenge, ferociously if necessary, but not to prescribe. Solutions must come from the boards themselves. This is their job. Back them or sack them.

Robin Buchanan
Senior partner
Bain & Company
London

SIR – You reinforce the need for today's corporate leaders to have resilience and emotional intelligence above all else. Rather than gung-ho charisma, the attributes leaders need are an ability to work with integrity and listen carefully at all levels, political agility, rapid anticipation of events and situations, and determination to seek a positive conclusion whatever the obstacles. Successful leaders also foster a genuine team environment in which senior executives are encouraged not only to take responsibility for the performance of their own teams but for the success or failure of the business as a whole.

Our own leadership and coaching work with chief executives and boards worldwide also demonstrates the importance of empathy and emotional self-management as prerequisites for effective performance. It also proves unequivocally that organisational climate predicts the performance of the organisation. The fact that up to 70% of the variance in organisational climate is caused by leadership style makes a clear case for directors to start adjusting behaviour and performance to achieve a demonstrable impact on the bottom line.

Zoe Gruhn
Director of leadership and coaching
Hay Group
London

Fannie and Freddie break up

SIR – There is still a window (albeit a tiny one) for America's government formally to rescind its unintended promise to bail out Freddie Mac and Fannie Mae (“Whose is the fairest of them all?”, October 18th). If markets currently believe that the American housing-finance bodies are “too big to fail” then the government needs to downsize them rather than become further entangled in and responsible for their increasingly indecipherable activities.

A blueprint exists: the break up of AT&T and creation of the Baby Bells. The White House needs to stop posturing about a new regulator and get moving on a break-up plan for Freddie and Fannie. It must announce that any financial support will be phased out before there are more surprises. Or before privately funded mortgage lenders force their hand by filing antitrust actions.

Maureen Bolton
Cedar Rapids, Iowa

Fowl play

SIR – Your article on cockerels concludes that while “selective pressures are universal” the female of the species has “not invented the rolling pin with which to discipline [her] erring mate” (“Cocks of the rocks”, November 8th). Have you never heard of battery hens?

Coll Hershman
Newbury, Berkshire

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Japan's election

Intimations of a sunrise

Nov 13th 2003 | TOKYO
From The Economist print edition

AP

The result was exciting. But will it help or hinder Junichiro Koizumi's drive to bring real structural reform to Japan?

Get article background

NO DOUBT about the symbolic winner of Japan's lower-house election on November 9th. The beaming smile of Naoto Kan, head of the Democratic Party of Japan (DPJ), filled television screens and newspapers across the country. Mr Kan has now given Japan what it lacked for so long: a mainstream party capable of challenging the dominant Liberal Democratic Party (LDP) at the polls.

The DPJ gained 40 seats in the election, winning 177 in all, especially in the cities and suburbs. Left- and right-wing parties alike took heavy losses, with the leaders of both the New Conservative and Social Democratic parties defeated in their own districts. The always feisty Communists had their worst showing in decades, losing 11 of their 20 seats. Thus the DPJ, in only the third lower-house election since the party was formed in 1996, has emerged as a clear and credible choice for disgruntled mainstream voters. Suddenly, Japanese democracy looks alive and kicking.

The name of the prime minister, however, will not change. Junichiro Koizumi's LDP, despite losing ten seats, still did well enough to hold on to power. After welcoming three independents into the fold, the LDP commands exactly half of parliament's 480 seats. Its planned merger with the devastated New Conservatives should hand the LDP four more seats and a simple majority; the 34 seats of its other partner, New Komeito (the political wing of Japan's largest lay Buddhist organisation), give the coalition a cushion. Everyone is now eager to see how Mr Koizumi and his party will handle their reprieve.

Yet the outlook for the prime minister's “structural reforms”—a raft of supply-side measures designed to overhaul the economy and spur it back to life—will remain unclear for at least a while longer. One reason for this is Japan's half-century history of one-party dominance, which has long confined the most important battles to within the LDP itself. Indeed, since Mr Koizumi took over in April 2001, the main political contest in Japan has pitted LDP members who back him against LDP members who despise his fiscal discipline and pro-competition policies. A shift towards a two-party system, if that is what the DPJ's strong showing has truly set in motion, will have a big impact on this contest. But the next round of the fight will be within the LDP, as usual.

Will the voice of Japan's voters help to sway the outcome? Perhaps, but it is far from clear what the voters have just said about those reforms. They clearly like the idea of political competition. In a poll

after the election, 69% said they welcomed the dawn of two-party politics. But they have yet to embrace fully the economic competition and supply-side reforms that Mr Koizumi, and parts of the rival DPJ, have championed.

Compare Japan's electoral landscape with those that confronted Ronald Reagan and Margaret Thatcher, two foreign leaders to whom Mr Koizumi's supporters often compare him when they appeal for patience. In 1984, when Mr Reagan's re-election campaign declared “morning in America” after the dark days of the downturn, the changes he was pushing—more deregulation, riskier labour markets and fewer subsidies—were as scary to many Americans as the prospect of domestic competition and small-business closures are to most Japanese. The same was true in Britain, where in 1983 Mrs Thatcher could point to few rewards after her first term as prime minister, but told voters that more liberalisation was necessary. The two leaders, in effect, asked their citizens: are you brave enough to carry on with what needs to be done? Many voters said Yes, and both won a second term.

Lionheart and his baiters

In this week's election, however, neither Mr Koizumi nor the DPJ asked voters this question. That may seem odd, since Mr Koizumi, nicknamed “Lionheart”, seems to talk of nothing else. He took over the LDP two-and-a-half years ago after promising “reform without sacred cows”. He has battled with his party to hold down spending on public-works projects, which have overrun the country with dams, bridges and roads to nowhere. His own party members now blame his stinginess for keeping the economy sluggish.

Mr Koizumi has also promised more attacks on government subsidies. He has repeated his pledges to privatise public road corporations and the postal system. And he has stuck to his policy of making banks shed bad loans from their books, despite widespread criticism that bankruptcy rates are already too high.

Even before this election, however, there were signs that the most painful bits of Mr Koizumi's agenda were not especially popular. Polls have shown that voters are more fond of Mr Koizumi than they are of structural reform per se. They like his style and energetic media appeal, as well as his willingness to criticise the LDP's vested interests. Foreign policy has also helped rally support around him. Fear of North Korea's nuclear brinkmanship, and anger over revelations that North Korea had abducted many Japanese citizens in the 1970s and 1980s, have been especially useful to Mr Koizumi.

AFP

If Koizumi offers pain...

In some ways, therefore, the DPJ's electoral challenge offered the first good test of voters' appetite for freeing the economy. Many DPJ members believe that Mr Koizumi's reform agenda has only two flaws: it does not go far enough, and he cannot enact it anyway because of resistance from his own party. This message is most appealing to voters in Tokyo, which is not just the seat of government but also the business and media capital, and which is most exposed to foreign ideas. The DPJ has done well in Tokyo in previous elections. It has struggled most in rural districts, where government subsidies are cherished and supply-side reforms are least popular.

The DPJ's chief campaign gimmick, a “manifesto” of detailed proposals, accused some of Mr Koizumi's reforms of being too timid. It criticised his half-hearted attempts to grant more autonomy to local governments, vowing to be much tougher on the central bureaucracy. The manifesto was even more averse than Mr Koizumi has been to public-works spending, pledging to slash the budget for such projects by 30%. It promised to cut the cosy links between bureaucrats and the industries they regulate, and even pledged to shrink parliament by 80 seats.

A frightening landscape

Since the DPJ has done well at the polls by criticising Mr Koizumi for not being reformist enough, is more reform what voters want? On the surface, perhaps. But dig deeper, and there is little evidence that they are truly keen on widespread economic competition. Many big-business leaders certainly want it, at least if they are running companies that have already taken pains to restructure and cut costs. They are tired of seeing uncompetitive firms, propped up by government subsidies and forbearing banks, undercut their prices and tie up resources. Some young and confident Japanese, who have less invested in the current system, are also more willing to try something new.

Many other people, however, including those who voted for both the mainstream parties, are terrified by the changes they see in society and in the economic landscape. Besides bankruptcy and unemployment rates that seemed unthinkable a decade ago, they are worried by rising crime rates, and are especially uneasy about the role that foreign criminals and disaffected youngsters play in that trend. A looming shortfall in the pension system, combined with the aftermath of Japan's collapsed land bubble, is causing many of them to worry about their own or their parents' retirement.

Along with these other anxieties, Japan's voters harbour an intense fear of economic competition—something many of them have never really experienced. This may seem strange for a country that, not so long ago, terrified western economies with its cheap, high-quality exports of cars and electronics. Much of the country's manufacturing industry remains impressively efficient, having taken steps during the 1990s to stay sharp in the face of growing global competition.

Most of Japan's domestic economy, by contrast, has long behaved very differently. The distribution system, which is stuffed with tiny enterprises, is woefully inefficient. The same is true of many other protected sectors. Construction firms, utilities, telecoms, farmers and the health-care system have fallen well behind America in measures of productivity. When Japan's economy was booming, the problems in these sectors were easily ignored. Huge trade surpluses helped to drive incomes upwards, and egalitarian business practices allowed domestic companies to siphon off much of the wealth.

After more than a decade of stagnation, the main problem with these sectors now is a socialised financial system that does not encourage weak firms to go out of business. The tax code, the public-works budget and opaque subsidies play a role in propping them up. So does the generosity of many big companies, who face little pressure from banks or shareholders to boost profits, and therefore continue to coddle their long-standing suppliers. The banks themselves have faced too little pressure from regulators to cut off lending to moribund firms.

Shocks to the system

In other words, the “special interests” holding Japan back are, in reality, the bulk of the electorate. For a long time, voters did not mind the inefficiency and corruption these practices generated, since the result was a domestic economy that also functioned like a welfare system. Now, however, the mounting hardships and insecurities are starting to take their toll. What voters appear to be doing, therefore, is looking for ways to lash out at the system without actually hitting themselves.

This is not an easy task, but they are getting better at it. Voters in the cities and suburbs, for example, seem increasingly willing to blame rural areas for holding them back. Cutting off explicit spending for construction projects in remote areas is clearly a vote-winner for mainstream politicians, and both Mr Koizumi and the DPJ have championed the idea.

Anyone with longstanding ties to the political system is also in trouble. During the campaign, the DPJ pointed repeatedly to the prevalence of second- and third-generation politicians in the LDP. Politicians have long been able to use their grass-roots organisations to get children elected. That was harder this time, especially in the cities. Voters even rejected the third son of Tokyo's governor, Shintaro Ishihara, one of Japan's most popular politicians, as well as the son of Mr Kan himself. The DPJ also made gains by running young—and therefore innocent—candidates. It managed to get 43 candidates under 40 elected, four times as many as the LDP.

The DPJ also attacked the other obvious special interest group: bureaucrats. Japan's bureaucracy has been rocked by scandals for years, and the tide of outrage has been rising steadily. Since the last election, the public has put up with revelations involving tainted beef, bad milk, health-and-safety risks at theme parks, cushy contracts for road-related companies, and the revelation that cracks in many nuclear reactors had gone unreported and unrepaired for more than a decade.

Japan's bureaucracy has been rocked by scandals for years, and the tide of outrage has been rising steadily

In the DPJ manifesto, the most important promises come under the heading of “showing the bureaucrats who's boss”. The DPJ pledged to stop them working for the companies they regulate after they retire. It vowed to trim their ranks and make them work for the cabinet, rather than the other way round. It also endorsed several reformed ex-bureaucrats as candidates, who turned out to be even more vicious than other candidates in excoriating their former ministries.

The DPJ's most powerful attack on the bureaucracy involved proposals to decentralise spending by granting more autonomy to local governments. The most popular politicians in Japan in recent times have been maverick governors who have promised to get tough on the central bureaucrats. The DPJ helped its cause greatly in this election by championing the locals' cause. Mr Kan told voters that the flamboyant governor of Nagano—who works in a glass office so that everyone can see whom he meets—would join the DPJ cabinet if the party won the election.

Yet attacking narrow special interests is a far cry from embracing economic competition for everyone else. The best example of this is Japan's continuing passion for protecting small- and medium-sized businesses. Mr Kan's main criticism of Mr Koizumi in the campaign was that the prime minister is not spending enough money on them. Mr Kan agrees with Mr Koizumi that depositors' accounts in the postal savings system are misused by the government; but instead of encouraging that money to flow where investment returns are highest, he would prefer to divert the funds towards small-business subsidies. Given the role banks play in propping up inefficient small firms, moreover, the DPJ's recent silence on the issue of non-performing loans speaks volumes.

The battle ahead

In short, both halves of the LDP have good reason to be worried about the election's outcome. For the moment, the old guard is almost pleased that the party did only moderately well at the polls. This is proof, they say, that Mr Koizumi is on the wrong track. Because he failed to lubricate the traditional LDP electoral machinery—including farmers, construction firms and small businesses—the party was unable to grind out enough votes in many hard-fought districts. Moreover, they say, Mr Koizumi's policies of cutting public works and encouraging banks to abandon weak borrowers have hurt the economy.

EPA

Good LDP country, still

The trouble with this argument is that the only three things the anti-Koizumi wing can offer—more concrete, old men and a pledge to do nothing—are not going to win over angry and anxious mainstream voters. Yet Mr Koizumi will have to battle to assuage them, too. He needs to convince them that Mr Kan was wrong to label him a compromiser, and therefore he will have to get tougher on his opponents in the LDP. But there are only two ways to do this, each of them risky.

One approach would be to press on strongly with the core of his structural-reform agenda. That means dealing seriously with non-performing loans, and risking many more bankruptcies. But that, in turn, involves challenging Japan's voters to be brave, something Mr Koizumi has so far been reluctant to do. The other option is to focus on the policies and interest groups that voters clearly dislike, and attack them. Mr Koizumi could maintain his tough stance against public-works spending, for example, and forge ahead with plans to privatise the road corporations. Mainstream voters, it appears, will like this. The risk here, however, is that without deeper structural reforms the economy will not improve, and voters will make Mr Koizumi a target of their wrath.

The only policy that seems a clear winner, at this point, is to press for more decentralisation. Mr Koizumi has already done this to some extent, by allowing special economic zones where normal business regulations can be relaxed. Promoting a genuine decentralisation of budgets, however, would require the prime minister to be much tougher on the central bureaucracy than he has been to date.

If he is willing to take them on, Mr Koizumi can portray himself as the national counterpart to all those

maverick governors, removing power from the Tokyo elite even as he brings jobs and growth to the regions. This strategy would be far more likely to end stagnation if it went with a hard new attitude towards small businesses. But even as part of a more modest programme, it would be a good start.

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Howard Dean

The doctor is in (the driving seat)

Nov 13th 2003
From The Economist print edition

Getty

The leading Democrat's successes reflect his rivals' weaknesses as much as his own strength

HOWARD DEAN, the former governor of Vermont, has been favourite to win the Democratic nomination to run against George Bush since mid-summer. That was when he scooped an unexpectedly large $7.6m of campaign contributions in the second quarter—far more than his rivals; when he started to appear at or near the top of polls in Iowa and New Hampshire, the states which hold the first votes for the Democratic presidential candidate next year; and when his signature issue—the mistakes of the war in Iraq—changed from an obsession of the Democratic left into a nationwide concern.

This week, Dr Dean's campaign took two more big steps forward. On November 8th, he said he would forgo federal financing for his primary campaign—and would not be bound by the spending limits that go with it. And on November 12th, he received the endorsements of two large unions, the Service Employees International Union (SEIU), which is the largest affiliate of the AFL-CIO organisation, and the even-more influential American Federation of State, County and Municipal Employees (AFSCME). These two achievements turn him from a “presumptive favourite”, still within reach of rivals, into a “prohibitive favourite”—whom his rivals can beat only if he trips himself up.

Of these events, the union endorsements do most to change the race. Both SEIU (1.6m members) and AFSCME (1.4m) are big. They are strong in Iowa and New Hampshire and capable of sending lots of loyal volunteers on polling day. With turnout in primary votes dismally low, this could be decisive. Dick Gephardt, a congressman from Missouri with strong links to labour, has also won the backing of 20 unions, but most are smaller and less well organised than Dr Dean's duo.

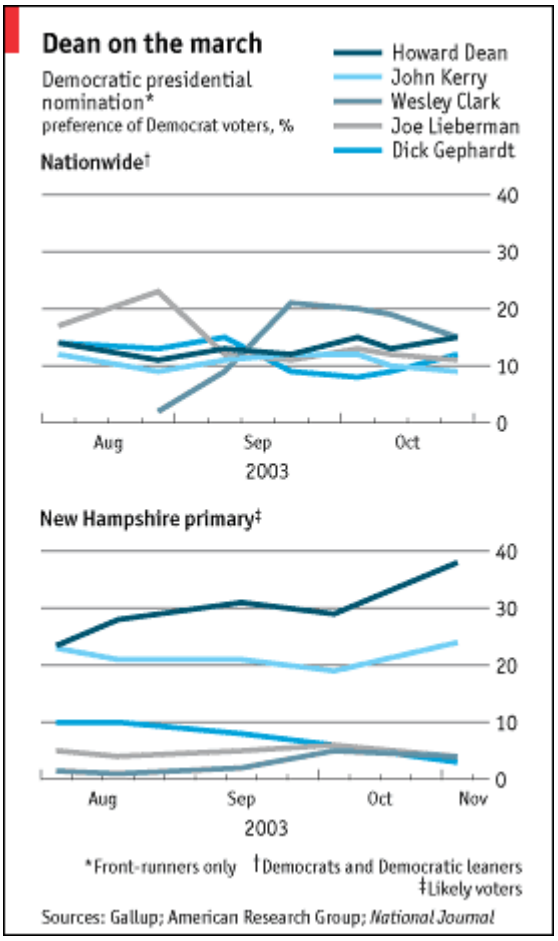
The unions' actions may also begin to provide Dr Dean's insurgent, bottom-up campaign with a bit of top-down support from the Democratic establishment. Gerald McEntee, the head of AFSCME, has a reputation as one of the politically canniest union leaders. Most union leaders said they would not endorse anyone until they were confident they had someone capable of beating Mr Bush. The co-ordinated endorsements this week suggest some think Dr Dean is the one.

The money matters for different reasons. As Norm Ornstein of the American Enterprise Institute points out, now that Dr Dean is a strong favourite, he will face simultaneous challenges from different candidates in different places—Mr Gephardt in Iowa, John Edwards in South Carolina, Joe Lieberman in Oklahoma. The money will make it easier for him to fight them all at once.

But his decision to eschew public financing—an embarrassment for a candidate who once supported it—is

really a general-election strategy. Any candidate who accepts public money is likely to spend up to the limit it imposes merely to win the primaries. So after a bruising battle, the winner will emerge with no money to hit back against a rampant Mr Bush (nominated unopposed) who is preparing to unload a barrage of anti-Democrat advertising in the spring and summer. This week, Mr Bush seemed likely to surpass the $100m mark in his own fund-raising. By avoiding spending caps, therefore, Dr Dean is displaying confidence in his ability to win the nomination.

Most important, his fund-raising success reveals an even-more impressive organisational achievement. As Noam Scheiber argues in this week's *New Republic*, the Dean campaign has become the first to show that the internet really can revolutionise politics, as webheads have long said but have not demonstrated how.



The Holy Grail of American politics is to identify your core supporters and then get them to the polls. In the past this was done expensively by going out to find them, knocking on doors, cold calling and so on. The Dean campaign discovered, almost by accident, that its supporters were willing to come to it—for nothing, by e-mailing its website. It started organising online events ("meet-ups"), attracting more e-mails. Almost 500,000 people have signed up at deanforamerica.com—a huge number, and almost double the following Dr Dean claimed in August.

This gives the doctor two advantages in the primaries. The first is at the polls. These supporters should vote for him. Even if only a fraction of them do, it could still be decisive in low-turn-out primaries. They also organise others to do the same. So the online campaign sustains itself. The recruiting drive has been so successful that Dr Dean has "volunteer brokers" (whose job is to get more volunteers) in the way other candidates have money brokers. The second advantage is to do with money. These online Deanites form a new kind of donor base. When Dr Dean was considering whether to eschew public financing, he e-mailed all his online supporters for their opinion. They not only backed him but also sent in $5m in 48 hours—more than any rival had raised in the whole third quarter.

Dr Dean's internet operation has transformed the race. At the start, he was a classic insurgent—a quixotic candidate from a tiny state, with no money, no name recognition and an intriguing health-care plan. Now he is in equal first place in the admittedly meaningless national polls (alongside Wesley Clark who seems to have peaked). More important, he has a double-digit lead in New Hampshire over John Kerry, the one-time front-runner, and is in a close race with Mr Gephardt in Iowa. He is streets ahead in

the “invisible primary” (the battle for the party's money, mood and momentum). If he wins the first two real primaries, his rivals may well be toast.

All the same, the real reasons for Dr Dean's success reflect at least as much on his rivals' weaknesses as on his own strengths. These reasons are the war in Iraq, anger at Mr Bush and (no less important) the frustration of Democratic activists with their own party. There is no guarantee that these things (even perhaps Iraq) will help Dr Dean much in the presidential contest, if he gets that far.

Dr Dean is the only serious candidate to have opposed war in Iraq from the start. But that distinction—so vital to anti-war activists—comes partly by default. As Charlie Cook, a veteran observer of politics, remarks, if Mr Kerry, who voted against the first Iraq war, had done the same with the second one, Dr Dean would still be an asterisk now and Mr Kerry the front-runner. Moreover, the doctor is being rewarded in the primaries for a position that looks, at the moment, a liability in the general election. Opinion polls show a majority of voters support the Iraq war but dislike aspects of the occupation—the position actually espoused by Mr Kerry and others.

Next, Dr Dean reflects the anger of Democratic voters at Mr Bush. A recent poll showed that 26% of voters feel ashamed that Mr Bush is their president. Anger continues to fuel activists and big donors. George Soros, a currency-trader-turned-philanthropist, has pledged up to $15m to anti-Bush organisations. But Americans are rarely motivated by revenge in presidential votes. Conventional wisdom holds that they want to look ahead. Anyway, that 26% is smaller than the number of Democrats who say (in a different poll) that they want a moderate, or a conservative candidate.

The kingmakers got it wrong

Lastly, Dr Dean benefits from activists' anger at the Democratic establishment, which in turn has been divided and uncertain. Most of the senior politicians from the liberal north-east threw their weight behind Mr Kerry, but the Kerry campaign is a shambles. He has just fired his campaign manager; his press officer and a deputy finance director left in protest. The Clintonian centre rallied around Wesley Clark, but his campaign too is imploding. General Clark has been unprepared for basic questions. (What is your position on Iraq? He flip-flopped.) He also still lacks a proper organisation. As for the Democratic right, it has been steamrollered by the enthusiasm of insurgents and paralysed by its own inability to decide between Senators Joe Lieberman and John Edwards.

Revealingly, even when all these candidates gang up on Dr Dean, it has backfired. They recently criticised his flirting with divisive symbols in appealing to voters “with Confederate flags in their pickup trucks”; Dr Dean's core supporters rallied round him, regardless.

Passion, technology and the weaknesses of his rivals: all these things have propelled Dr Dean into a dominant position before the primaries. Yet even if he wins the nomination, these things may offer little help against Mr Bush. It is one thing to sign up 500,000 activists, quite another to win 50m votes.

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About sponsorship

The economy, jobs and steel

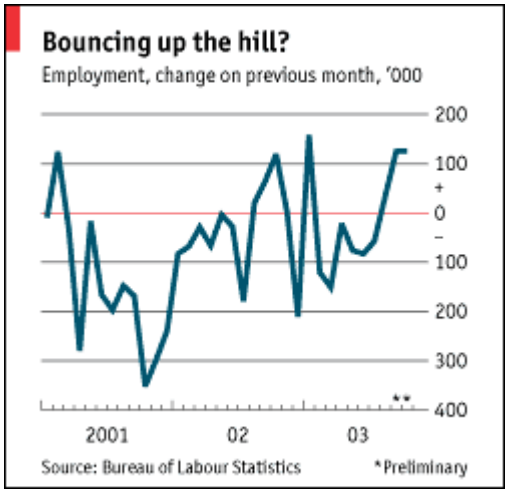
Hard decisions

Nov 13th 2003 | WASHINGTON, DC
From The Economist print edition

The labour market is improving, but the White House is still worried

AFTER months of dreading each new employment figure, the White House is now getting used to good news. Not only did the economy create 126,000 net new jobs in October, far more than analysts expected, but also the figures for August and September have been revised. Rather than losing jobs in August, the economy actually created 35,000 new ones. Meanwhile, the number for new jobs in September went up from 57,000 to 125,000. Add to these figures separate evidence from falling unemployment claims, and the case for a turnaround in the gloomy jobs market seems increasingly robust.

Still, it is too early for Mr Bush's team to relax. While 126,000 net new jobs is the best monthly job gain since January, it is also barely enough to keep up with growth in the size of the labour force. To make a serious dent in the unemployment rate, the pace of job creation needs to accelerate. The case for a turnaround has been helped by other data, particularly the rise in corporate investment. But in a recovery that has seen several false starts, and that is heavily reliant on fiscal and monetary stimulus, the White House can hardly take a sustained boom for granted.



All the same, there has been a change of mood in the Republican camp. Instead of fretting about the parallels with the jobless recovery that cost George Bush senior the 1992 election, Republicans now point to similarities with the roaring recovery that propelled Ronald Reagan to a landslide re-election in 1984. Meanwhile the better news limits the scope for Bush-bashing from the Democrats, though that did not stop their presidential candidates pointing out this week that the overall good figures for October masked the loss of another 24,000 jobs in manufacturing.

As both sides know, the manufacturing slowdown has been particularly painful in the battleground rust-belt states. The White House has been careful not to sound too rosy about the economy. Mr Bush spent far more time this week dwelling on how to improve the jobs situation than he did on the latest good news. And his economic advisers spent much of this week arguing about the political consequences of a policy originally seen as a sop to the rust-belt: steel tariffs.

In theory, free trade is part of Mr Bush's recovery strategy. Promoting free-trade agreements appears alongside tax cuts in Mr Bush's much-touted “six-point plan” to boost the economy. The hitch: back in March 2002, he slapped three-year “safeguard” tariffs on many steel imports, officially to help the industry restructure, unofficially to pander for its votes. This week, the World Trade Organisation pronounced America's actions illegal; if it does not change its ways by December 15th, the European Union will impose its own tariffs worth $2.2 billion (see article).

The kick in the tail

This causes all sort of problems for the White House's political job-mongering. The steel industry is concentrated in four key states—West Virginia, Ohio, Indiana (all won by Mr Bush last time) and Pennsylvania (which Al Gore won and Mr Bush has devoted huge amounts of time to wooing). Yet there is also a much larger and increasingly vocal group of steel users, including carmakers, who say that the

higher prices caused by the tariffs are hurting manufacturing. These users are mainly in industrial states such as Michigan, Illinois and Wisconsin (all of which Mr Gore won in 2000), but they can also be found in steel-producing states such as Indiana.

As Mr Bush is aware, the tariffs are popular: according to a recent poll, seven in ten voters in Pennsylvania, West Virginia and, oddly, Michigan, favour keeping them. But if the White House keeps the tariffs and the EU retaliates, the politics will get trickier still. The Europeans have designed their threatened tariffs to cause the White House political pain: the list of targeted goods includes orange juice (which would hurt Florida) and various textiles (bad news for South Carolina).

As the White House searches for a way out of this mess, Mr Bush may reflect on two things. The first is the fact that protectionism, even of a targeted sort, comes with a kick in its tail. That may deter him from pandering to pressure to get tough with China, something that many manufacturers are demanding. Second, all this tricky politicking will be easier if the jobs market continues its recovery. The White House will be waiting nervously for each monthly job number for some time yet.

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Judicial nominations

Waiting for Godot

Nov 13th 2003 | WASHINGTON, DC
From The Economist print edition

A perverse bit of politicking with plenty of long-term consequences

AP

Brown, lady-in-waiting

THE semi-annual fund-raising drive by the Public Broadcasting Service is in danger of losing its hard-earned position as the most boring event in America. On November 12th, Republican senators started a 30-hour talkathon to protest against the Democratic Party's delaying of George Bush's judicial nominations. The Republicans stocked up with food and cots for their ordeal. John McCain suggested that the chamber should be divided into snoring and non-snoring sections.

Republicans are furious that the Democrats have repeatedly used a delaying device known as a filibuster to prevent the Senate from holding votes on conservative judges. The Republicans, with a 51-48 majority, can nominate the judges. But it takes 60 senators to break a filibuster and force a vote on the Senate floor.

Miguel Estrada recently withdrew his nomination for the US Court of Appeals for the District of Columbia circuit, after two years of filibustering. Several other nominations are being stretched on the filibuster rack: Priscilla Owen, Charles Pickering, William Pryor and Janice Rogers Brown. The atmosphere is so poisonous on the Senate Judiciary Committee—particularly between Orrin Hatch, the committee chairman, and Patrick Leahy, his Democratic counterpart—that aides joke that the Department of Homeland Security should screen senators for weapons and sharp objects before they enter the hearing room.

The Republicans insist that the Democrat's routine resort to the filibuster is unprecedented. Mr Estrada is the first judicial nominee ever to withdraw his name because of a filibuster. The Democrats retort that the Senate has been confirming Bush nominees at a record-breaking rate: 168 have been confirmed. Mr Bush has got more judges confirmed in his first three years in office than Ronald Reagan got in his first four. The Senate blocked far more judicial candidates during Bill Clinton's presidency than it has during Mr Bush's.

There is some truth in the Democrats' claim that they are being selective in whom they target. The Department of Justice lists just 41 vacancies out of an 877-strong federal bench—a 4.7% vacancy rate (the lowest since 1990). But the Republicans stress that, if you narrow it down to the US appeals courts, which decide on tricky judicial issues and provide a pool of candidates for the Supreme Court, the picture changes: only 29 of Mr Bush's 46 nominations to the appeals courts have been confirmed, a lower

confirmation rate than Mr Clinton faced in his first three years in office.

One reason for the war is that judges matter. The appointments are for life. The fiercest battles have been over nominations, like Mr Estrada's, to the DC appeals court, the second most prominent in the land after the Supreme Court. But the parties are also both pandering to their political base. Filibustering allows Democratic senators to prove to their rank-and-file that they are capable of standing up to the hated Bush White House. The talkathon shows Republican senators are willing to fight for conservative nominees.

The Republicans seem to be playing this game better—cleverly selecting what sort of people to serve up to the Democratic filibuster machine. The Republicans responded to the filibustering of Mr Pryor, Alabama's attorney-general and a devout Catholic, with an ad showing the front doors of a courthouse with a sign reading “Catholics need not apply”. They have just used the filibustering of Mr Pickering, a popular judge in Mississippi, to help install Haley Barbour in the governor's mansion. Above all, they have been careful to select minority candidates.

Ms Brown, the latest martyr on the filibuster rack, is a sharecropper's daughter who grew up in the segregated south, worked her way through law school in California, and is now on the California Supreme Court. Al Sharpton, one of two black presidential candidates, has sharply criticised his party for using the filibustering technique, even though he does not support Ms Brown's nomination. Bizarre and dull though it may be, the political stakes in the talkathon are pretty high.

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The diner rolls on

Burger's revenge

Nov 13th 2003 | JERSEY CITY AND LEBANON, NEW JERSEY
From The Economist print edition

New affection for an old way of eating

WHAT makes a diner? The hearty, cheap food? The 24-hour breakfasts? The unlimited coffee? The pleasant if harried waitresses? The swivel-top counter seats? All that stainless steel? “Ask ten different people and you'll get ten different answers,” says Peter Genovese, a newspaper columnist and author of the book “Jersey Diners”. What nobody argues about, though, is the fact that New Jersey, even more than other north-eastern states, loves these places. “There's no such thing as a diner come-back,” says Mr Genovese. “Here, the diner never went away.”

Diners first appeared in the 1870s in Providence, Rhode Island, as mobile food-servers on work sites. Gradually these wagons turned into more permanent structures that could, at a pinch, be broken down into their separate parts and towed to a more promising location. Diners often became the focus of their neighbourhoods, offering a place for local people of all ages to meet and talk.

With about a dozen diner manufacturers of its own, New Jersey eventually became Diner Central. Mr Genovese reckons the state now has roughly 600 diners, fewer than in their heyday but more than a few years ago—and more than you might expect, given the twin onslaughts of fast-food restaurants and Starbucks-style coffee houses. Although in recent years diners have spread in other parts of America—and, drop your voice, in Europe too—their appeal remains strongest in the north-east.

Most of these diners are owned and run by big families, many of them of Greek origin. The successful ones can pull in millions of dollars a year in earnings, and big enough profits for their owners to wave aside offers from real-estate developers. “Kids are going to college and culinary school and coming back to run diners because they're a big business,” says Robert Kullman, president of an old diner-making company here in Lebanon.

Today's New Jersey diners range from the humble Bendix in Hasbrouck Heights, a family operation run by John Diakakis, who is blind, to the slick, newly renovated Tick-Tock in Clifton. The state is home to a White Manna diner in Hackensack and a White Mana one in gritty Jersey City, tiny, porcelain-clad palaces filled with customers at odd hours. Both have stared down competition from nearby fast-food outlets.

Offering ham-salad sandwiches for $2.22, tuna sandwiches for $3.30 and a “Big Web” burger for $2.03, the White Mana pulls in plenty of customers who like the special feel of a diner from busy national Route 1 outside its doors. Mario Costa, the White Mana's owner since 1979, once misguidedly agreed to sell it to a buyer who planned to tear it down and put up a chain-franchise outlet. Then Mr Costa changed his mind, and paid a heavy price to buy it back. “It becomes part of you,” he says.

In many diners the style is still the Art Deco of the 1930s and 1940s. But quite a few are getting a technological face-lift. A new diner on the campus of New Jersey's Montclair State University features laptop hook-ups. A New York-based company called PrimeSelections has begun replacing old-fashioned jukebox terminals in diners with touch-screen systems that will give customers access to cartoons, video games, e-mail and television. The firm's goal is to have 20,000 units installed in 1,000 locations in a year's time. It is betting that the diner will remain a social magnet for years to come.

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Mental illness

Locked up

Nov 13th 2003
From The Economist print edition

Prisons have replaced hospitals as the main home for the mentally ill

IN AN Illinois prison, one inmate hears voices of dead people. To relax, he cuts his legs and arms, and has been trying to eat his own flesh. In Indiana, another prisoner believes there is a radio in his nerves and often picks at his ear to find the receiver. These two are not alone. The American Psychiatric Association has estimated that as many as one in five of those behind bars has a serious mental illness.

Some 300,000 people in American prisons suffer from mental disorders ranging from major depression and post-traumatic stress to schizophrenia—three to four times more than the number in mental-health hospitals. In a recent report, Human Rights Watch (HRW) argued that the penal system is “not only serving as a warehouse for the mentally ill but is also acting as an incubator for worse illness and psychiatric breakdowns.”

Fifty years ago, says HRW, more than half a million Americans lived in public psychiatric hospitals. Today, proper hospitals house fewer than 80,000 people. This is largely a sign of progress. The development of new drugs has made it possible for the mentally ill to be treated outside hospital. And there is far better legal protection to prevent people from being locked up against their will.

Nevertheless, things have not gone to plan. When many of the country's mental-health hospitals were shut down in the 1960s, the idea was that patients would be looked after by local health systems. Instead, the mentally ill often have little access to treatment, and many have ended up on the streets. According to the National Resource Centre on Homelessness and Mental Illness, up to one in four homeless people has a serious mental illness.

Once on the streets, and with only meagre health care, it is often only a matter of time before a mentally ill person commits a crime and is sent to jail. For instance, the number of mentally ill in Santa Clara County's jails jumped by 300% in the four years after a nearby Californian state hospital closed down. Another study showed that the arrest rate of mentally ill people rose five-fold in the first eight years after the rules tightened about whom was allowed into mental hospitals.

Tougher sentencing policies are also pushing mentally ill people towards prison. America's prison population has more than quadrupled over the past 20 years, largely because of the war on drugs. The minor misdemeanours for which mentally ill people get arrested increasingly draw prison sentences: three-quarters of the new arrivals in state prisons are there for non-violent offences. And the famous “not guilty by reason of insanity” plea is increasingly rarely used. Shocked by the fact that John Hinckley used this defence to escape punishment for shooting Ronald Reagan in 1981, many states restricted a defendant's right to plead insanity. Utah, Montana and Idaho abolished it.

There is a perverse economic logic in the mentally ill ending up in prison, rather than hospitals. American prisons, after all, have been far more successful than mental-health systems at protecting their budgets from cost-cutting politicians. It is also cheaper to house the mentally ill behind bars than in a state hospital. On the other hand, the prisons are not designed to treat the mentally ill. They are bad at rehabilitating “normal” prisoners, and they usually make mentally ill people iller still.

The problem has got bad enough for some politicians to reconsider the current tough policy, and try to divert non-violent mentally ill offenders away from prisons. There are now 90 special mental-health courts in more than 20 states; these can sentence minor offenders to treatment programmes rather than prison. A bill is being considered in Congress that would provide money for such courts, as well as more cash for treatment and housing. It will cost money; but Congressman Ted Strickland, a Democrat from Ohio who has sponsored the bill, says that the alternative is accepting “incarceration and homelessness

as part of life for the most vulnerable population among us".

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The Supreme Court and Guantánamo Bay

Help from above

Nov 13th 2003 | LONDON AND NEW YORK
From The Economist print edition

The court gives America's least-loved prisoners a bit of hope

Get article background

TO THE relief of many of America's allies, not least Tony Blair, the Supreme Court announced on November 10th that it would consider the fate of the 660 foreign “enemy combatants” held at the American naval base at Guantánamo Bay in Cuba. Some have been there for nearly two years without being charged and without any access to lawyers. The appeal had been filed on behalf of 12 Kuwaitis, two Britons and two Australians, who are demanding the right for their cases to be heard by proper American courts, as opposed to the military tribunals the Pentagon is supposed to be arranging for them.

The Supreme Court will not consider whether the detainees are being held illegally. Instead, it will look at the technical issue of the legal status of the Guantánamo base, and whether America's civilian courts have jurisdiction over its detainees. In making that decision, the court may also examine the status of all foreigners captured overseas in the war on terror. But even if the court decides that American law extends to the Guantánamo base, thus giving the detainees the protection of the American constitution as well as access to civilian courts, they will still have to convince the courts that they should be freed.

Even with these provisos, the decision to hear the case is a surprise, for several reasons. The Supreme Court is usually extremely reluctant to query any of the executive branch's decisions about security in time of war. The appeals met none of the usual unofficial criteria the court uses to select the 100 or so cases it accepts for review each term. Indeed, the lower courts have produced no conflicting rulings (the main test for selection by the Supreme Court). Instead, they have so far unanimously backed the government's line—that the Guantánamo base, leased in perpetuity from Cuba, is not part of the United States, and so America's civil courts have no say over what happens there.

The solicitor-general, Theodore Olson, had urged the Supreme Court not to hear the detainees' appeals. He pointed to a 53-year-old Supreme Court ruling concerning German prisoners captured in China after the second world war. In that ruling, the court held that “aliens detained by the military abroad” have only those rights that are “determined by the executive and military, not the courts”. Giving Guantánamo detainees access to civil courts would “directly, and perhaps gravely, interfere with the executive's conduct of the war and divert the attention of the military from ongoing hostilities abroad to courtrooms at home,” argued Mr Olson.

However, at least four justices decided that in this case there was a need to examine the balance between the demands of national security and individuals' rights to due process. After a visit to the camp last month, the International Committee of the Red Cross broke its traditional silence to issue a public protest about their “unacceptable” situation. The physical condition of the prisoners, who include a 13-year-old, was fine, but there was a “worrying deterioration” in the detainees' mental health caused by their legal limbo. The first question they all asked was: “What's going to happen to us?” There had been 32 suicide attempts by 21 prisoners over the past two years. Many prisoners were suffering from clinical depression.

A lot of conservative Americans feel, as George Bush put it in front of a plainly embarrassed Tony Blair earlier this year, that the Guantánamo prisoners are just “bad people” and deserve no better. Foreigners claim double standards. America tried John Walker Lindh, the American Taliban, in a proper court. Surely their citizens deserve the same rights? In public, Mr Blair calls it “an irregular situation and (one) we would want to end as swiftly as possible”. In private, his advisers call the military tribunals “a disaster” for America's image.

At the root of the argument sits the prisoners' status as enemy combatants. If they had been held as prisoners of war, under the third Geneva Convention they should have been tried “as soon as possible”. The Bush administration insists that the Guantánamo suspects are not POWs, because they were captured without uniform. As enemy combatants they can be interned without trial for the duration of hostilities.

Civil libertarians point out that America's war on terror, unlike conventional wars, could go on forever. No military tribunal has yet begun. And the suspicion that the Bush administration simply wants to lock up the detainees for as long as possible has been strengthened by remarks from Donald Rumsfeld, the blunt-speaking defence secretary and overseer of the tribunal process: “Our interest is not in trying [the prisoners] and letting them out. Our interest is—during this global war on terror—in keeping them off the streets, and so that's what's taking place.”

In the end, the Supreme Court will have to balance two concepts—the courts' deference to the executive branch on issues of national security during time of war, and any individual's right to due process. Merely by taking on the case, the justices have backed one part of the detainees' brief—that “it is for the courts, not the executive, to determine whether executive action is subject to judicial review.” The court's decision is expected by July.

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Lexington

Arnold the bipartisan

Nov 13th 2003
From The Economist print edition

With verve and luck, Arnold Schwarzenegger's politics may work

Get article background

THE bomber jackets, open-necked shirts and unpressed chinos are back in the closet; the new uniform is a suit and tie. What looked right for Arnold Schwarzenegger on the campaign trail would look a bit insolent in the corridors of government. The movie-star knows how to dress the part. But does he know how to govern? One obvious precedent for the 38th governor of California, who will be sworn into office on November 17th on the steps of the Sacramento Capitol, is the sainted Ronald Reagan. But it could just as easily be Jesse “the Body” Ventura, the wrestler who in 1998 rode a populist wave to become a one-shot, ultimately ineffectual, governor of Minnesota.

The sceptics are already preparing the political obituaries. Unlike Mr Reagan, Arnold is too inexperienced. There is still that past sexual misbehaviour to rake over (“playful”, according to the supposedly remorseful culprit; grossly offensive, according to the alleged playthings). The state's problems are too intractable. The budget alone is enough to make any Californian moneyman tear out his transplant. Creative accounting was used to close a deficit of $38 billion for this financial year (ending June 2004), but it has still left a “structural” deficit of about $8 billion. Add another $4 billion because of Mr Schwarzenegger's promise to rescind a tripling of vehicle-licensing fees on day one of his tenure, and another $13 billion if the courts rule that recent bond issues, approved by the legislature but not by the voters, are unconstitutional. And Mr Schwarzenegger needs to come up with a budget for the next financial year by January 10th.

However, the underlying challenge has to do with the partisan nature of Californian politics, where the state presents an extreme version of the national picture. Thanks to redistricting, the state legislature is split between increasingly left-wing Democrats (who have big majorities in both houses) and a rump of increasingly hardline Republicans, typified by Tom McClintock, the conservative state senator who refused to bow out of the governor's race. How hard is Arnold—who claimed he would “send a message to the political class that it will no longer be business as usual”—prepared to push the legislature?

This question is of interest well beyond Sacramento. Virtually every other governor in the country faces a sharply divided state legislature. Some Republicans point to Washington for inspiration. Facing a divided Congress, and with a far weaker electoral mandate than Mr Schwarzenegger's, George Bush in 2001

charged off in an unambiguously rightward direction, and managed to push through a huge tax cut. But Mr Bush was a conservative with the backing of his party which, at the time, narrowly controlled Congress (until the White House's “extremism” drove Jim Jeffords out of the party, temporarily handing control of the Senate to the Democrats). There are no real Schwarzenegger Republicans in Sacramento; most of his party derides Arnold, with his Kennedy-clan wife and his liberal views on abortion and homosexuals, as “Republican-lite”. To achieve anything, he has to win over some Democrats.

One ominous portent for the gubernator is his current spat with the Democratic state attorney-general, Bill Lockyer. Last week, to the fury of the Schwarzenegger camp, Mr Lockyer suddenly revived talk of the “gropinator”, calling for an independent inquiry into the sex allegations. Can this really be the same Mr Lockyer who boasted of crossing party lines to vote for Mr Schwarzenegger? In the context of Sacramento politics, it can be. Mr Lockyer, with his eye on the gubernatorial election due in 2006, does not want to cede ground to Phil Angelides, the Democratic state treasurer who is already hounding the governor over his promise to balance the budget without raising taxes.

Accentuate the positive

Despite this, there is a case for forgetting the pessimism “and all that stuff” (as Schwarzenegger sentences tend to end). If Arnold stands for anything it is “thinking positive”, a mantra that sounds less of a cliché when you consider his extraordinary career. He has already bullied into life a team of advisers who span the political spectrum from Willie Brown, the liberal mayor of San Francisco, to George Shultz, a former Republican secretary of state. His education adviser is Richard Riordan, a former mayor of Los Angeles, and his finance director is Donna Arduin, who has balanced budgets in New York, Michigan and Florida. Already there is talk of a clever route out of the budget mess: Mr Schwarzenegger will ask the voters to approve both a borrowing of $20 billion and a cap on future spending. In other words, there will be enough money to cover the deficit, the governor will have kept to the letter (if not entirely the spirit) of his pledge not to raise taxes, and he will have sidelined the legislature.

Another reason why Mr Schwarzenegger's governorship of Californian unity stands a chance is because the legislature is in something of a funk. In theory the lawmakers' positions are impregnable (thanks to gerrymandering, only 15 of the 100 legislature seats up for election next year look competitive). But none of the party barons foresaw the sacking of Gray Davis, re-elected as their governor just one year ago, and the polls show that the legislators are even more unpopular than he was.

Momentum alone may give Governor Arnold a honeymoon start. He should get a special session of the legislature that would quash Mr Davis's idea of giving illegal immigrants driving licences and would also carry out a pro-business reform of the compensation given to injured workers. Then much depends on the economy. But if Mr Schwarzenegger's luck holds (and, like Mr Reagan, he has a knack of attracting that invaluable political commodity), the state could be well on the way to recovery by the time people start thinking about the 2006 election. Politicians may have to bite their lips and follow Mr Schwarzenegger. For all his weaknesses, the gubernator has a chance.

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Award: legalising drugs

Nov 13th 2003

The Economist has won the Edward M. Brecher award, given by the Drug Policy Alliance, for our coverage of the debate about legalising drugs.

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A rising star in Mexico

The man who would be president

Nov 13th 2003 | MEXICO CITY
From The Economist print edition

Notimex

Mexico City's can-do leftist mayor is the early favourite for the presidency in 2006. Can he last the distance?

Get article background

FOR political junkies, there is only one place to be at dawn in the capital city: at the mayor's daily press conference. At 6.15am every day, Andrés Manuel López Obrador steps in front of the cameras in the mayor's offices. About an hour later he strides out of the room to begin a working day that usually lasts until 10pm. The message is that this is a man who cannot wait to get behind his desk to serve the people. And the early start ensures that it is Mr López Obrador who sets the city's daily political agenda, and often that of the nation, on the breakfast news shows.

His industry and astuteness have turned Mr López Obrador, a pragmatic left-winger, into the rising star of Mexican politics. The next presidential election is not due until 2006. But already the mayor is seen as the man to beat. His manic work habits are reminiscent of Álvaro Uribe, Colombia's president. But the Latin American leader Mr López Obrador is most often compared with is Lula, Brazil's moderate left-wing president.

He owes this inflated status in large part to the political vacuum created by the failure of Mexico's president, Vicente Fox, to fulfil promises of reforms and economic growth. After his conservative National Action Party lost heavily in mid-term legislative elections in July, Mr Fox's fate now lies in the hands of the former ruling party, the Institutional Revolutionary Party (PRI). It holds the largest number of seats in Congress, and continues to frustrate the president's programme. This gridlock is Mr López Obrador's trump card. While other politicians bicker, the mayor presents himself as a man who gets things done for the capital's 8.8m people.

Like Mr Fox, Mr López Obrador has been in office for three years, but has more to show for it. He has given priority to vigorous social programmes with national relevance. He has launched a scheme under which over-70s receive a monthly allowance of 688 pesos ($63) for food and household goods. He gives grants to the disabled, and helps single mothers with their children's education. He has opened 12 new schools (the first in the city for over 20 years) and a new university. To tackle Mexico City's notorious traffic, he has built, in record time, a second tier above a stretch of a ring-road. He has launched an

ambitious project to restore much of the city's run-down and dangerous old centre.

Cynics claim that these measures are designed to raise the mayor's approval ratings rather than tackle underlying problems. Maybe. But, above all, the mayor's policies are designed to deliver tangible results fairly quickly. There is nothing the mayor enjoys more than to show the president around his newest bit of pavement or flyover, as if to rub in the contrast between mayoral can-do and federal drift. Such things cost money, and the city's debt is rising. But so are its tax revenues, and the debt is not out of control.

Mr López Obrador still spouts left-wing rhetoric against neo-liberalism and the United States. But what marks him out is that he is a pragmatist, “willing to move beyond party and ideology to build a constituency,” says Federico Estévez, a political scientist at ITAM, a Mexico City university. To get things done, the mayor has formed some surprising alliances. Carlos Slim, Latin America's richest businessman, is a fan, and has financed much of the restoration of the city centre. For advice on tackling crime, Mr López Obrador called in Rudolph Giuliani, a Republican former mayor of New York City.

An ability to transcend his core left-wing support was what finally allowed Lula to win Brazil's presidency, at the fourth attempt. It will be vital for any López presidential bid. His left-wing Party of the Democratic Revolution (PRD) has only 95 seats in the 500-seat lower house of Congress. It barely makes a mark outside its power-base in central Mexico.

When it does, it is often as a force set firmly against change. Cuauhtémoc Cárdenas, the PRD's founder and defeated candidate in three presidential elections, this week formed an unholy alliance with the most retrograde elements of the PRI to oppose Mr Fox's plans to allow private investment in the electricity industry. So Mr López Obrador's first battle will be within his party, to secure its nomination and to impose a more flexible programme.

Apart from pragmatism, the mayor's chief asset is a reputation for honesty. So far, his administration has been a model of parsimony. There are no foreign junkets. He pays famously low wages to his staff, for whom the honour of serving the people is supposed to suffice.

The big risk for his presidential hopes is that he has become the favourite so early. Over the next 32 months, he will face relentless scrutiny. Scratch the polls more closely, and nuances emerge. The mayor enjoys an approval rating of over 80% in the capital. But on specific issues, such as crime, that drops to about 40%. Discontent may mount: the high-profile programmes have come at the cost of neglecting other, creaking, public services, such as the metro and water treatment.

As with Colombia's Mr Uribe, along with popularity has gone a certain high-handedness. Mr López Obrador learned his politics in the PRI, in Tabasco state, a bastion of corrupt machine politics against which he eventually rebelled. During his first three years as mayor, he lacked a majority in the city council. He often ignored it, or vetoed its proposals.

He shows scarcely more respect for the courts. He is now defying a judicial order to indemnify the owners of land taken over by the city back in 1989. He argues, probably correctly, that the original deal was corrupt. But his assertion that the courts should not override “popular feelings” or the “human laws of the people” suggests that he might flout constitutional conventions if he gets the top job. For now, though, Mexico City's people seem happy enough to have a mayor who has managed to do anything at all. And the rest of Mexico wants a piece of the action.

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Colombia's government

Falling back on friends

Nov 13th 2003 | BOGOTÁ
From The Economist print edition

A less than convincing reshuffle

Get article background

AP

Modernising Martha, and museum pieces

WHAT began as a setback for President Álvaro Uribe is starting to look like a partly self-inflicted rout. After a referendum on fiscal and political reform narrowly failed last month, it was widely expected that Mr Uribe would fire its architect, the discredited interior minister, Fernando Londoño. What was not foreseen was that the reforming defence minister, Martha Lucia Ramírez, would go too, to be followed by another minister and the commanders of the armed forces and the police. Some of the changes betray a whiff of presidential panic, just when urgent legislative battles loom.

In 16 months in office, Mr Uribe has offered Colombians bold leadership with his effort to impose “democratic security” on a country suffering violence from two guerrilla armies, right-wing paramilitaries and drug traffickers. Yet he seems to have been deflated by the failure of the referendum, and the success in local elections the following day of left-wing opponents. Mr Londoño inadvertently gave an insight into the president's state of mind when, in private comments that became public, he mused that Mr Uribe might resign.

That brought a swift denial, and the minister's sacking. His replacement, Sabas Pretelt, is a Conservative, like Mr Londoño. That is a nod to an important member of Mr Uribe's coalition. But Mr Pretelt has little political experience, having headed the National Federation of Commerce, a business lobby, for the past 14 years. Another businessman, Jorge Alberto Uribe (no relation), a childhood friend of the president, takes over at the defence ministry.

Mr Pretelt's task is to shepherd unpopular tax increases through Congress before it goes into recess on December 16th. The referendum had included cuts in wages, pensions and the bureaucracy, aimed at saving around $1.1 billion (or 1.2% of GDP) per year. Instead, the government is now seeking to raise an extra $1 billion in taxes next year, by raising income tax, eliminating VAT exemptions, and levying a tax on pensions.

That risks damping down a promising economic recovery. But it is essential to control the fiscal deficit, and to gainsay speculation that Colombia might default on its debt. Mr Pretelt should help to blunt opposition to the tax increase among business. He is better placed than the arrogant Mr Londoño to obtain co-operation from Congress. But he still faces a hard sell.

The departure of Mrs Ramírez, Colombia's first female defence minister, looks like a big step backward. She had clashed with General Jorge Enrique Mora, the armed-forces commander. That was partly a personality conflict, but mainly because she and her team of bright young civilian advisers were trying to make the forces more effective and efficient. They were responsible for Colombia's first coherent defence policy, whose aim was to reconquer territory from guerrillas and paramilitaries by protecting the civilian population, rather than treating it as a foe.

The corollary was to subject the armed forces to far closer civilian control. Mrs Ramírez obliged the army to take part in a joint-intelligence committee, for example. She also wanted administrative reforms, to prise control over contracts from the general's grip and outsource the army's rations. That provoked an

angry exchange of letters with General Mora, after the minister had asked the public auditor to investigate waste.

These reform efforts were fought by “a reactionary faction” led by General Mora, according to a senior defence official. The general retired this week—but he succeeded in taking down the minister first. That sends “a really bad message,” the official says. Mrs Ramírez was “the guarantee that you could have a strong security effort that was based on strong principles of the rule of law”.

Some of her reforms will no doubt survive. This week, for example, the president fired the police chief, and four other police generals, over the misuse of funds. But without Mrs Ramírez and Mr Londoño, the cabinet is long on nonentities.

Despite his troubles, Mr Uribe remains very popular: in a poll taken after the referendum, 82% expressed approval of the president. One interpretation of the changes is that he has moved to defuse simmering opposition, in Congress and the army. Another is that a rebuffed president, always mistrustful of politicians and of subordinates who shine too brightly, will now rely even more on a narrow circle of old friends and businessmen. If so, that would bode ill for Colombia.

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Canada's defence policy

On the cheap

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The armed forces suffer from government indifference

AP

LAST month two Canadian soldiers were killed in Afghanistan when they drove over a land mine. An inevitable accident of war, you might think, except that their vehicle was 20 years old and lacked armour—a death trap, rather than a lifesaver. Their fate is symptomatic of the woeful state of Canada's armed forces. During the 1990s, the defence budget was cut by about 30% in real terms, while deployments continued apace. Such is the resulting accumulated strain that unless the government invests billions of dollars in new equipment, the armed forces face “extinction” as a capable fighting force within 15 years, according to Brian Macdonald of the Royal Canadian Military Institute, a defence think-tank in Toronto.

Canada has a proud tradition of taking part in peacekeeping operations. More than 3,500 of its soldiers are abroad, in places such as Afghanistan and Bosnia. A report on defence in 1994 promised that up to 10,000 troops would be available for service abroad. But lack of equipment makes that impossible.

Defence spending has sunk to just 1.1% of GDP, its lowest level since before the second world war. That compares with an average among NATO members, excluding the United States, of 1.9% of GDP. Manpower in the services has fallen by roughly 30% over the past decade to fewer than 60,000. The shortfall is now critical: training of recruits has been disrupted because instructors have had to be sent abroad.

Equipment is in an even worse state than manpower. Capital spending takes up 18.5% of the defence budget. That is enough to equip only one of the three services properly, says Mr Macdonald. The navy has some modern ships, but is short of spare parts. Worst hit is the air force, with just 350 aircraft, down from 725 in 1991. It is flying 40-year old transport aircraft and has had to cut maritime patrol flights. Its elderly fleet of Sea King helicopters (known as “flying coffins”) require 30 hours of maintenance for every hour of flight. And they are unavailable for operations 40% of the time, according to David Rudd, of the Canadian Institute of Strategic Studies, another Toronto think-tank. Its Hercules transport aircraft, dating from the 1960s, are in even worse repair. The result is that Canada must depend on American planes to take its troops abroad.

This penury reflects the low priority given by voters to the armed forces. Many Canadians would rather that scarce government money was directed to health and education. That is what has happened. Facing a huge budget deficit, Jean Chrétien's government took an axe to defence spending in the mid-1990s. Recently, improved public finances have allowed it modestly to increase the defence budget again, by C$1 billion ($1.3 billion) in 2003-04, for example.

Paul Martin, who as finance minister implemented the cuts, is due to be elected as the new Liberal leader, and thus prime minister, at a party convention this weekend. He has promised to spend more on the armed forces. But economic growth, and thus tax revenues, have slowed. Overstretched cities and provinces are clamouring for more funds, too.

Despite the difficulties, Canadian troops have peformed well as peacekeepers, in the Balkans and Afghanistan. What is needed is an overall review of defence and foreign policy. But it may take more

deaths before that happens.

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Chile's right-wing opposition

Loveless relationships

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From The Economist print edition

A sex scandal poisons an alliance

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THE allegations are lurid. A local businessman and gym-owner is said to have procured homeless adolescents and teenage prostitutes for sessions of drug-fuelled sado-masochistic sex. Among his clients, the story goes, were two senior politicians from the right-wing opposition, as well as one from the governing coalition. The subsequent furore has not done much to establish the truth of these claims, if there is any. But it has stirred up simmering resentments in the Alliance for Chile, the opposition's uneasy coalition.

The allegations came last month from Pia Guzmán, a congresswoman for National Renewal, the smaller of the Alliance's two members. She did not name names. But others did, pointing the finger at two senators, Jovino Novoa and Carlos Bombal, both from the Independent Democratic Union (UDI), the larger and more right-wing of the two parties.

The UDI issued furious denials, filed charges of slander against Mrs Guzmán, and accused her party's leader of complicity in her actions. Fair enough, except that it made the UDI look insensitive to serious alleged crimes. Pablo Longueira, the party's normally rational president, then told a radio programme that details of a plot to destroy the UDI had been revealed to him in his bedtime prayers to Jaime Guzmán (no relation to Mrs Guzmán), its founder, killed in 1991.

Squabbling within the Alliance is nothing new. But now the leaders of the two parties are said to be barely capable of being in the same room together—just when they are supposed to draw up a strategy for local elections next October. The Alliance hopes that a strong performance will be a prelude to winning a presidential election in 2005: the ruling centre-left coalition has been in office for 13 years, and is weary.

Shielded by a tight ring of advisers, Joaquín Lavín, the UDI's presidential standard-bearer, has been invisible during the row. That may be wise. But some in the Alliance worry that he lacks the qualities of leadership required for an election that, with the economy reviving, no longer looks in the bag.

By then, the current scandal will no doubt be long forgotten. Attention is already shifting: in the latest twist, the judge in the case was removed last week, after he acknowledged visiting a homosexual bathhouse. The Alliance is unlikely to collapse over the affair: both parties know they have nowhere else to go. But they have even less love for each other than they had before.

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Politics in China

Gate-crashing the party

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AP

A year after Hu Jintao took over as Communist Party leader, there are faint glimmers of reform. But there have been too many false dawns before

Get article background

IN THE spacious fitness centre of a luxury residential compound in Beijing, the head of the landlords' committee, Shu Kexin, explains why he is now engaged in a bid to get elected to his district's virtually powerless legislature. “I'm not interested in the elections. What I want is to use these elections to show people that they have the right [to stand], that they can do this without being sent to prison or getting in trouble,” says Mr Shu, who is also a specialist in public policy at one of the city's top universities.

Every five years, urban Chinese go through the ritual of voting for candidates selected by the Communist Party and about whom they are told next to nothing to fill seats in the district congresses. These form the bottom rung of a multilayered parliamentary system and are the only level at which the party allows even the pretence of public participation in the choice of delegates. In early December it will be the capital's turn. But this time Mr Shu, and several other Beijingers, are determined to break with tradition and get their names on the ballot sheets without the party's prior endorsement.

Remarkably, Mr Shu's campaign has been given favourable coverage in official newspapers. Even the party's most authoritative mouthpiece, the *People's Daily*, said in August that allowing more people to recommend themselves as candidates would make local congresses “livelier”. Could it be that China's sweeping change of leadership in the past year, including the appointment of a new party chief, president and prime minister, has also broken taboos against political reform?

The party knows the dangers. In 1980, newly appointed reformist leaders also allowed independent candidates to stand in local congress elections. In Beijing's university district this caused an upsurge of heated political campaigning among students. Candidates seized the opportunity to attack party rule and call for far-reaching democratic change. The reformists then got cold feet and barred winners with radical views from taking up their seats.

For the past 23 years officials in Beijing have preferred caution. Although China's election law says that anyone can nominate himself as a candidate with the support of ten voters, until now no one in the

capital has been able to do so. Elsewhere there have been several cases, including the election of an independent candidate in the central province of Hubei in 1998, Yao Lifa. But local officials have often contrived to frustrate aspirants.

Now the mood is changing. The official media paid particular attention in May to elections in the go-getting southern city of Shenzhen, where candidates put up campaign posters (usually forbidden in China) and an independent won a seat.

But, despite this encouragement, Mr Shu is still struggling. Election officials have told him, questionably, that his ten nominators must belong to his neighbourhood's election committee. But they have not told him who is on this committee or how to contact its leader. He says that security agents have quizzed his acquaintances. Officials, ever suspicious of any non-party organisation, especially one with a political hue, have refused to recognise the campaign team whose formation he declared in July.

Beijing in 2003 is a long way from recapturing the excited electoral atmosphere of 1980. The red banners that flap in the chill breeze calling on citizens to “develop socialist democracy” through the upcoming elections do little to inspire a population made cynical by decades of such propaganda. Campuses are quiet, even though a few university students are among those who now hope to stand independently in next month's polls.

But since Hu Jintao took over from Jiang Zemin as party chief a year ago this week, and as president in March, many intellectuals have expressed hopes that the party may end its foot-dragging on political reform, though few dare openly to call for a multi-party system. Such hopes have been raised not by any policy pronouncements, but by the relatively open-minded image that Mr Hu and Wen Jiabao, who succeeded Zhu Rongji as prime minister, have tried to project. Their tardy but ultimately resolute handling of the SARS respiratory-infection crisis earlier this year, especially the sacking of Beijing's mayor and the minister of health for failing to respond more effectively, heightened expectations of a new style of governance.

The kind of reforms that mainstream intellectuals want to see pale in comparison with the radical views expressed on campuses in 1980 or on the streets during the Tiananmen protests of 1989. In China today, thanks to rapid economic growth in at least the main urban areas, the significant loosening of the party's grip over personal and intellectual life, and the negative (in Chinese eyes) lessons of much of eastern Europe and the former Soviet Union, there is little obvious appetite for any dramatic move towards full democracy.

For all that, many Chinese outside and inside the party recognise that inflexibility, secretiveness and lack of oversight in the political system have become dangerous liabilities. These deficiencies have left the party riddled with corruption and arthritic in its response to the many crises that rapid social and economic change, as well as a fast-evolving international security environment, inevitably spawn.

Corruption and the abuse of power are widely seen as threats to the wealth of a fast-growing middle class. “Now that I've earned a certain amount of money, money has lost its importance. My interest now is how to supervise the people who say that they work for me,” says Mr Shu, who owns several apartments.

Hu's disappointing start

Will Mr Hu have the courage to deliver more change? He has won praise for dispensing with some of the frippery and privilege of the past. He scrapped the time-wasting ceremonies for top leaders when they embark on or return from foreign trips. He cancelled this summer's annual conclave of top leaders at the beach resort of Beidaihe. He ordered the media to stop filling up airtime and newspaper columns with reports of inconsequential leadership activities (this last injunction has been implemented only patchily).

AFP

Does Jiang (left) have a plan for Hu?

But it was Mr Jiang who laid the groundwork for more thoroughgoing change in his farewell report as party chief a year ago. All the talk since then of political reform, including the need for greater democracy within the party and expanded participation in political affairs, stems not from any new thinking by Mr Hu, but from the guidelines set out in Mr Jiang's valedictory speech.

Mr Hu himself has equivocated. Many Chinese intellectuals expected new measures of political change—particularly democratic reform within the party—to be unveiled in his speech on July 1st marking the official anniversary of the party's founding. But Mr Hu failed even to mention the issue. Given the questions raised by the SARS epidemic (and aired even in some official newspapers) about the need for better government, this omission was startling. Expectations were again dashed in mid-October when the party's 356-member Central Committee held its first meeting since the leadership changes. A communiqué mentioned in passing the need for political reform to be carried out in an “active and stable manner”, but said nothing about what this should involve.

The only institutional change sponsored by Mr Hu has been a new requirement that the Politburo present a report on its work to the Central Committee once a year. The official media have praised this as a step towards greater scrutiny of the Politburo's intensely secretive operations. In the past few months the press has been allowed to issue brief reports on at least some Politburo meetings after their conclusion—the first time since the 1980s that ordinary Chinese have been regularly informed of their occurrence. And, unusually, the dates of last month's Central Committee meeting were announced in advance. But these are petty adjustments.

September saw reports of a new party directive banning public discussion of political reform or of constitutional change. The issue had been a hot topic among intellectuals ever since it was revealed, earlier this year, that moves were afoot to revise the constitution at the annual session of the legislature next March. The likelihood is that both Mr Hu and Mr Jiang were starting to feel nervous about the upsurge of open calls for more far-reaching change than the party was prepared to discuss.

Among the most outspoken advocates of reform has been Cao Siyuan, an economist who runs a bankruptcy consultancy in Beijing. Mr Cao organised a conference in June in the eastern city of Qingdao to discuss revisions to the constitution. These would, among other things, enshrine the principle of open government and do away with the constitution's preamble, which specifies that China shall be ruled by the Communist Party as a “people's democratic dictatorship”. Some 40 academics as well as serving and retired officials took part. Mr Cao points out that this was the first time he had organised such a forum since shortly before the 1989 unrest.

China's new leaders must have felt uncomfortable with the comparison. Mr Cao says that since late July plain-clothes police have followed him everywhere and, he suspects, tapped his phones. Talks he had arranged to give at various meetings have been mysteriously cancelled. “You could say these police tactics are [the leadership's] response” to the Qingdao forum, he says. The authorities have also stepped up their efforts to stem the spread of politically sensitive views on the internet. Since the beginning of October, about ten people have been arrested, tried or sentenced to jail terms because of articles they have posted on websites.

Political reform in China has always moved in fits and starts. In 1998, Mr Jiang permitted a brief period of openness—even to the extent of tolerating, for a while, an opposition party that was set up that year. By the end of the year, though, most of the group's known members were arrested, and remain in prison today.

If Mr Hu is to succeed in bringing greater democracy to the party's inner workings, he too will want to be sure that no one will take this as a green light to start questioning the party's right to rule. Just as Mr Jiang cracked down ruthlessly on organised dissent, and yet tolerated and even encouraged limited experiments with political reform (such as direct elections of township governors in a few places), Mr Hu is likely to do the same.

So far, at least, the possibility of independent candidates in local elections has not produced obvious challenges to the party. Since the law already in principle allows independents to stand, Mr Hu can relax controls and see what happens without making any big changes, safe in the knowledge that ways can always be found of limiting the number of contenders (and how they campaign) in future polls.

There is little evidence that a conservative Mr Jiang is restraining Mr Hu from carrying out bolder reforms. Mr Hu's chief adviser on political reform is Vice-President Zeng Qinghong, a close ally of Mr Jiang's. Yet Mr Zeng is no conservative. He has encouraged quite a lot of debate, albeit mostly behind closed doors among party theorists, about ways to make the party more democratic and expand the use of elections to select lower-level leaders. Mr Zeng is also in charge of Hong Kong affairs, in which capacity he presumably gave his blessing to the territory's decision to shelve a proposed anti-subversion law that had set off large protests.

But, despite all the energetic thinking under way in the party, the Chinese are likely to be, as they have so often been before, disappointed by the results. Next year's revision of the constitution will focus mainly on giving greater protection to private property rights and enshrining Mr Jiang's contribution to Marxist-Leninist philosophy, a theory called the “Three Represents”, in the constitution's preamble. Further expanding grassroots democracy is not on the agenda.

Few Chinese could say what the Three Represents are, even though slogans calling on people to uphold them are displayed on billboards and daubed on walls across the country. Many of those who do know what the slogan means (that the party must represent China's advanced productive forces, its advanced culture and the interests of the overwhelming majority of the people) find the notion soporific.

Yet, buried in this morass of verbosity, is an idea that would have profoundly shocked both Marx and Mao. Mr Jiang's idea was that the bosses of private enterprises—once repudiated by Mr Jiang himself as exploiters of labour—could now be recruited as party members (the party had many private-enterprise leaders in its ranks already, but most had joined before going into business).

After Mr Jiang launched the Three Represents in 2000, party hardliners argued that the doctrine would turn the party into something akin to social-democratic parties in Europe, socialist in ideology but open to everyone and without any claim to an exclusive right to rule. Maybe frustrated democrats in China should take heart from this. History may one day remember Mr Jiang's Three Represents as a turning point in the party's evolution along the lines of Taiwan's Kuomintang, a once-Leninist party that decided democracy was not so bad after all.

If Mr Hu eventually plucks up the courage to begin changing the way his party rules, he will need to make bigger changes to the constitution than he or Mr Jiang has ever openly suggested. Mr Jiang can be credited with having encouraged direct elections to village councils and, more recently, urban neighbourhood committees. But these bodies are not part of the government proper. If current experiments with direct elections for township heads, who belong to the lowest tier of government, are ever to be promoted nationally, the constitution will need to be revised.

The pressure for change is growing. Township leaders are often the targets of sometimes violent demonstrations by angry farmers who object to the exorbitant fees levied by township governments to sustain their bloated bureaucracies and maintain basic services such as health care and education. A growing number of local officials believe that elections might help to ease the tension.

In August, Pingba township in the south-western municipality of Chongqing took matters into its own hands and tried to carry out direct elections without approval from above. The day before the vote, the township party leader who had tried to organise the ballot was placed under house arrest and the elections were cancelled. “Local cadres really want to have reform. They cannot wait for orders from the upper levels,” says Li Fan, a political scientist in Beijing who helped Pingba's leaders shape their plan.

Some shrewd Chinese argue that allowing more direct elections would be an excellent way of expressing the Three Represents, for without clear-cut public backing China's leaders can hardly be said to represent the people. But little evidence has yet emerged that Mr Hu, or indeed the author of the theory, is enough

of a risk-taker to push the new theory that far.

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The Afghan economy

It's hard going straight

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How can Afghanistan ditch opium and make an honest living?

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SEEING Afghanistan from the air helps to explain why it was once difficult to conquer, and is today difficult to govern. The mountainous and—the snowcaps of the Hindu Kush apart—largely parched terrain, traversed by only a few ragged roads, also helps to explain why the country has never been rich. Efforts to revive its economy must contend with this landscape, as well as with the legacy of war, which blighted the country's agriculture and ruined its fledgling industry. The protracted conflict also led to the spread of opium, a crop supremely suited to Afghan geography and the political instability it has helped to generate—instability that opium, in turn, now helps to sustain.

How to persuade the legions of labourers skilled in opium harvesting, not to mention the warlords who reap much of the profit, to find other sources of income? Opium prices, though falling, are still high, and the margins more than compensate for the risks incurred by the crop's nominal illegality. Changing the calculation of risk and reward will involve punishing poppy growers and opium distillers more consistently, and making trafficking harder and riskier. Most important, poor Afghans need other ways to make ends meet. Their country does not have Iraq's oil wealth, but there are possibilities.

The carpet trade is among the most promising. Afghan carpets are renowned for their beauty and durability. Yet many “Afghan” rugs on sale in the West are made in Pakistan, where much of the industry migrated during the decades of war. The remaining carpet makers in Afghanistan itself struggle to compete with their mechanised rivals in other countries.

Another possibility for growth is dried-fruit. Afghanistan used to be the world's biggest exporter of raisins, and a net exporter of food. Various other fruits and herbs are grown in the south and east, and businessmen talk of exporting flowers and cotton. The country has some oil, natural gas and coal, and

deposits of gold and precious stones. A gas pipeline from Turkmenistan, which would provide useful transit fees, is again being talked of.

President Hamid Karzai's government, which relies on foreign aid for most of its income, also wants to develop a tourist trade. This is not altogether unrealistic: the Afghan countryside, and monuments such as the stunning Blue Mosque in Mazar-i-Sharif, did indeed attract adventurous visitors in more tranquil times.

The difficulties lie in persuading investors that they can do business safely and economically, and that they will be able to get their goods to market. Mr Karzai's team has devised liberal trade laws, tax reforms and incentives to encourage enterprise and foreign investment. But it cannot as yet promise to enforce those (or any other) laws in much of the country. Landlocked and rugged, Afghanistan has never been ideally suited for export, even before war led to the destruction or neglect of many of its roads, along with much of its irrigation system. Travellers on the roads that remain face paying tolls at gunpoint, or worse. Airport capacity is too small for large-scale transit of high-value items. The new factories that might help the carpet industry to compete would require reliable power and water supplies.

The economy is nonetheless growing, though admittedly from a very low base, partly because of the end of a prolonged drought, partly because of the influx of aid money—though Zabihullah Moemenzada, an Afghan businessman, complains that too many reconstruction jobs are carried out by foreign companies and their imported workers. But the country will remain one of the world's poorest unless it finds a way out of its vicious circle. There can be little economic progress without security and stable government; but, without economic opportunities, many Afghans will continue to cultivate the poppy, enriching the warlords who thrive on and foment lawlessness.

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Sri Lanka

The smile on the face of the Tiger

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A divided government helps the secessionists

Get article background

DAUNTLESS optimism is a job requirement for Sri Lanka's peace activists. So the optimists say that the present confrontation between the president, Chandrika Kumaratunga, and the prime minister, Ranil Wickremesinghe, might force the pair to work together. That would remove one obstacle to peace in the long war against Tamil secession. However, a meeting between the two on November 12th ended with tempers a bit cooler, but no meeting of minds.

AFP

President and premier, getting on famously

The president said she wanted to discuss power-sharing. This was at least progress since the previous week, when, in a constitutional coup she had grabbed a slice more power without discussion, sacking three of Mr Wickremesinghe's ministers and imposing a two-day state of emergency.

But Mr Wickremesinghe wanted to talk about peace negotiations with the Liberation Tigers, who have been observing a 21-month ceasefire in their 20-year struggle for a Tamil homeland in the north and east of the island. The president's coup removed the prime minister's control of security issues and made it impossible for him to pursue negotiations.

Still, the prime minister was in a position of strength. Mrs Kumaratunga's party had failed to win over his parliamentary supporters. In Washington at the time of the coup, he returned bearing an international stamp of approval. The president appeared a self-seeking troublemaker. And although there is much sympathy among the Sinhalese majority for her argument that the government is ready to yield too much to the Tigers, her party would probably still lose an election.

It would not, however, lose badly enough to give the prime minister the two-thirds majority he needs to change the constitution. But change will sooner or later become essential. It is all too obvious that current cohabitation arrangements do not work. Also, formal peace would require a new constitutional framework.

So president and prime minister need each other for now. Mr Wickremesinghe, however, may prefer to avoid making any power-sharing commitments. If he waits until the presidential elections in 2005, in which Mrs Kumaratunga, having reached the limit of her term, cannot stand, he may well inherit her powers.

The Tigers, too, are probably calculating that Mr Wickremesinghe will be the easier negotiating partner. Certainly, in meeting Norwegian mediators on November 13th, they seemed keen to dispel fears that they might use the upheaval in Colombo as a screen for a military adventure. They have kept arming and recruiting soldiers through the truce, as Mrs Kumaratunga's camp has insistently pointed out.

Such warnings serve as a reminder that the schism in Sinhalese politics is only one of three big obstacles to peace. Another is that there will always be qualms about a deal that recognises the brutal Tigers as the sole representatives of the Tamil minority. And, third, their blueprint for their future homeland, whose publication helped provoke the president's coup, is far removed from Sinhalese notions of increased Tamil autonomy in a federal Sri Lanka. Events in Colombo have succeeded in focusing attention on the only one of these problems they cannot be called on to solve. It is enough to make a Tiger smile.

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Saudi Arabia

How safe is the House of Saud?

Nov 13th 2003 | RIYADH
From The Economist print edition

Reuters

Suicide bombers will probably not topple the Saudi regime, but they could tempt it to slow or reverse what passes for reform in the kingdom

Get article background

A YEAR ago, Saudi Arabia's interior minister, Prince Nayef, scorned the idea that militant Islamists posed a threat to the kingdom. They were mere chatterers and fabricators of nonsense, too lazy to get off their backsides, he said in an interview. The suicide bombing, on November 9th, of a palm-shaded housing compound in the suburbs of Riyadh, the capital, which killed at least 18 people and hurt 120 more, has buried such cosy notions.

The attack came on the night of the full moon that marks the middle of the fasting month of Ramadan. Assailants distracted guards with gunfire, letting accomplices drive what looked like a police car into the centre of the compound. The explosion flattened eight nearby villas and blew out windows a mile away.

It was not the first such murderous blast in the kingdom. A sequence of smaller strikes has killed half a dozen foreign workers, most of them westerners, in the last seven years. In May, suicide bombers hit two other expatriate compounds, killing 35 people. Since then, nationwide manhunts have left some 12 policemen and 18 wanted men dead. Twice as many terror suspects—600—have been captured since May as in the previous two years.

What was novel about this week's bombing was that it killed Arabs, mostly Lebanese and Egyptian professionals, and their children. Several of the victims were Muslim. This, and the fact that the attack took place during a month of special religious significance, has made Saudis more anxious and angry than ever before.

The government has been quick to claim the moral high ground. The top government-appointed religious authority condemned the attackers as agents of Satan. State television, whose normal task is to linger at royal receptions, instead broadcast live from the gory scene throughout the fatal night. Furious commentary flooded the state-monitored press. “You are either with the country or with terrorism,”

warned the daily *Al Watan*.

It's all America's fault

Many Saudi Muslims excused previous acts of terror on the ground that Islam itself was under threat from a rampaging America. If the acts themselves were misguided, they shrugged, at least the motive of *jihad* was pure. Earlier this year, for example, Safar al-Hawali, a popular preacher once imprisoned for his combative views, launched a group called the World Campaign to Fight Aggression. “We are one nation and one body; we share one goal and one clear enemy,” he declared. Although Mr Hawali said his group would adopt peaceful methods inside the kingdom, he endorsed armed *jihad* “wherever circumstances permit”.

Until now, few Saudis had heard coherent arguments against this idea of Muslim victimhood. Even when, in April, America withdrew the 5,000 troops it had long based in the kingdom (thus resolving one of Osama bin Laden's main grievances), few Saudis changed their minds about American “imperialism”. They were too busy watching footage from Afghanistan, Iraq and Palestine. Arab satellite channels ennobled the ideal of guerrilla “resistance”. The House of Saud, like other Muslim governments, fostered this sense of siege to boost its own popularity.

In this context, many Saudis sympathised with the youthful excesses of home-grown terrorists, or at least thought they understood the temptation to join the *jihad*. Even after the Riyadh bombing, anonymous writers on the internet chat sites where militant views proliferate have cited holy scripture to explain that the end justifies the means. In an e-mail to a Saudi magazine, a man purporting to lead a group called Mujahideen of the Arabian Peninsula claimed responsibility for the attack. If Muslim innocents died, he said, well, they should not have been consorting with infidels. (Perhaps he was referring to the fact that the bombed compound once housed workers for Boeing, the American aircraft maker.)

Yet very few Saudis now share such reasoning. This week, Mr Hawali himself denied that the Riyadh bombing could be considered *jihad*. “Our problem as Muslims is with those who seek to destroy us and our religion—and they are well known—not with the Arab and Islamic governments in our countries,” he said.

Mr Hawali and other Saudi radicals think the government should use them as a conduit to open a dialogue with the rebels. They say that most would turn themselves in if they were guaranteed fair treatment. But Prince Nayef rejects the notion, saying the only way to talk with them was with “rifles and swords”.

Such words worry liberal Saudis, who fear that too hard a crackdown will prolong strife and imperil reform. In recent years, the kingdom's elderly top princes have opened up a bit, welcoming foreign investment, deleting from school books passages warning children to shun infidels, and hinting that they may one day allow elections. In the long term, the monarchy's best chance of survival is to become less autocratic, and for some of its members to become less ostentatiously corrupt. It seems secure at the moment, buoyed by high oil prices, but the legions of unemployed Saudi youths may not always sit idly by as yet more princes award each other lavishly paid jobs.

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Iran's nuclear ambitions

Seen through?

Nov 13th 2003
From The Economist print edition

More disturbing details come to light

Get article background

IS IRAN preparing to give up its nuclear option, or just pursuing it more cannily? It says it has now given the International Atomic Energy Agency (IAEA), the UN's nuclear watchdog, a full—really, this time, honest—account of its nuclear activities. This week it “temporarily” suspended all uranium-enrichment and plutonium-reprocessing activity in the country. And it has agreed both to accept intrusive, snap checks of nuclear sites, and to adopt an additional inspection protocol that will turn these new rules into law. So, a triumph for concerted international pressure to end what most governments suspected was Iran's secret ambition to build the bomb?

Its new openness is to be welcomed. America's deputy secretary of state, Richard Armitage, recently suggested that even the Great Satan's relations with Iran might move forward a bit, if only to tackle its continued support for terrorist groups and its refusal to recognise Israel's right to exist.

Iran, for its part, has been keen to avoid the UN sanctions that would likely have followed had it continued to stonewall, but also to lift the darkening cloud over what it insists are its entirely peaceful nuclear plans. Russia, building Iran's first nuclear reactor at Bushehr, had let it be known that the project would be terminally delayed unless doubts about Iran's nuclear intentions were cleared up. This week, Russia was thinking aloud of a second Bushehr.

But the doubts are not so easily dispelled. Although an IAEA report leaked this week said there was no direct evidence that Iran was secretly developing nuclear weapons, John Bolton, the top American arms-control official, said this was “impossible to believe”. Until last month, the report says, when Iran handed over more facts about its nefarious nuclear activities, Iranian officials had spent 18 years telling inspectors lies.

Iran now admits that it violated its safeguards agreement with the IAEA, by producing enriched uranium, using both centrifuges and lasers (an expensive technology of no use in Iran's supposedly civilian nuclear programme). Only small amounts, and only the low-enriched stuff, not weapons grade, say the Iranians. But the agency is still worried by finding traces of highly-enriched uranium (enriched well beyond civilian needs): Iran blames contaminated machinery imports.

Among hundreds of other unreported experiments over the years were ones that mimic the extraction of plutonium from spent reactor fuel-rods. Plutonium has few uses: as specialised fuel for advanced reactors Iran has no plans to build, and as the fissile core of a bomb. Knowing how to make it means Iran would be able to turn the nuclear reactors it does plan to build into bomb factories, should it so choose.

And that is the real fear: that Iran has not given up its nuclear ambitions, just decided to pursue them for the time being within the nuclear rules. For unless its “temporary” suspension of nuclear-fuel dabbling is made permanent, its nuclear option cannot be safely closed off.

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America's Iraqi ambitions

There must be some way out

Nov 13th 2003
From The Economist print edition

Ideas, good and less so, for restoring security and transferring power

Get article background

AP

No end to the killing

IT WAS billed as a routine chat, but the return to Washington of Paul Bremer, America's chief administrator in Baghdad, for talks with George Bush this week looked a little more urgent. Their get-together added a gloss of panic to a grim week in Iraq for America and its allies.

For all their security troubles, the Americans have been able to tout steady improvements in life for Iraqi civilians. Mr Bremer's recall suggests that progress has been too steady for Mr Bush's taste. They and the president's aides were said to be mulling over ways to speed up the transfer of authority to Iraqis. One possibility might be to hold earlier elections than had been envisaged, creating an interim government that could oversee the writing of a constitution. Mutual recrimination broke out between the Americans and the Iraqi Governing Council it had itself appointed. The Iraqis were said to be slow and fractious; Iraq's interim foreign minister talked about “geriatric ambassadors” and “American infighting”.

Meanwhile, the security worries deepened. At least 27 people, including 18 Italians, were reported killed in a suicide bombing in Nasiriya on November 12th. Lieutenant-general Ricardo Sanchez, America's top soldier in Iraq, revealed that attacks on his men had risen from six each day five months ago, to between 30 and 35 a day now. He used the “w” word—war—to describe the ongoing hostilities. Two American helicopters have been shot down this month. American bombers have been called back into action.

“Iraqification”—turning over more power and security duties to Iraqis—is the solution under discussion in the White House: 131,000 Iraqis were involved in security at the Pentagon's last count, roughly as many as there are American troops in their country. Others in Washington are pushing for “Natofication”, arguing that NATO helmets would grate less than American ones, and that more international forces, which the Bush administration had hoped would help relieve America's burden, would be more likely to materialise if NATO were in charge.

But politically and practically, NATO is unlikely to be the answer. True, only 55,000 soldiers from NATO's non-American members are currently deployed on multinational missions, out of 1.4m people in uniform. Yet as Lord Robertson, NATO's chief, complains with exasperation, most of the rest are too badly trained, equipped or funded for missions like Iraq; governments moan that they are overstretched. Of those 55,000, quite a few are already in Iraq. Mustering a new NATO force sizeable enough to allow many Americans to go home would mean Britain sending back some of its troops, and hefty inputs from the three big stay-aways: Turkey, Germany and France.

That looked unlikely even before the deaths of the Italians. Iraqi reservations have already persuaded the Turks not to get involved. The Germans have vacillated, but seem unlikely to help much. The French could muster a force on the scale of the 9,000-strong British one, but might require another UN resolution before going in, even under a NATO flag. Natofication advocates point to Afghanistan, where the alliance's role has creepingly expanded. The Afghan experience is indeed salutary: NATO's involvement has grown only slowly and tentatively. Even with the best will in the world—and in Paris—the NATO cavalry would be slow to arrive. “Iraqification” remains a better bet—that, and better intelligence

to help the Americans catch their tormentors.

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Congo

Not as bad as dad

Nov 13th 2003 | KINSHASA
From The Economist print edition

But worries are growing about the young president, Joseph Kabila

Get article background

THE 32-year-old president's handsome face is quite unlike that of his murdered predecessor, whose jowly image adorns his office walls. But the handshake is the same. Joseph Kabila, the Democratic Republic of Congo's leader, has his father Laurent's meaty hands. This is startling, because Mr Kabila has done mercifully little else to recall his dreadful father, one of the architects of Congo's tangled five-year war, which has claimed at least 3m lives. In July, Mr Kabila declared the war over, and accepted his main rebel enemies into a government of national unity. But, as Congo's delicate transition begins, there are signs, mostly still hazy, that Mr Kabila may yet turn out to be his father's son.

Under the terms of a peace deal signed last year, Mr Kabila gave his armed and unarmed opponents three out of four vice-presidencies and some 40 ministries in the new government. Mr Kabila and the rebels have all pledged to form political parties to fight elections due within three years. Yet Mr Kabila appears to remain in control—at least, as much as anyone can be in such a vast, violent and roadless place as Congo.

This may reflect Mr Kabila's relative popularity. Having grown up in Tanzania, he is still scarcely known to the Congolese, but many credit him with bringing peace. Congo's latest bout of war began when Rwanda invaded it from the east in 1998 and most of Congo's neighbours piled in on one side or the other. Earlier this year, at least in part thanks to Mr Kabila's sensible diplomacy, the last foreign troops withdrew, leaving their increasingly isolated rebel proxies behind. These are the groups that Mr Kabila has accepted into his government in Kinshasa, the capital.

By comparison, Azarias Ruberwa, one of his new vice-presidents, may be the most detested man in Congo. His rebel group, the Rally for Congolese Democracy (RCD), was raised and run by Rwanda. Even in the distant east, which the RCD still controls, Mr Ruberwa is considered a traitor. Nor is Jean-Pierre Bemba, another rebel vice-president, universally loved. The irascible Mr Bemba was recently referred to the UN's International Criminal Court at The Hague in connection with his Ugandan-backed fighters' alleged penchant for eating rainforest-dwelling pygmies—which Mr Bemba denies.

Still, in Congo, where no democratic election has ever been held, popularity is less important than cash. And here too Mr Kabila's faction appears to have the upper hand. To accommodate the 40 new ministers, many old ministries were broken up. In the process, the old government managed to claw back some lucrative portfolios, including those that dispense licences to distribute oil and set up mobile-phone networks. Diamond exports are also subject to the old regime's rules, despite the efforts of an energetic new minister of mines, who recently tried to block the export of stones worth $10m to an Israeli-run company, but was overruled by his deputy—Mr Kabila's former chief of mines. Another of Mr Kabila's allies is Katumba Mwanke, the new government's secretary-general, whom the UN has accused of involvement in the theft of state assets worth more than $5 billion.

Mr Kabila may have some dodgy friends, but he has some good advisers too. Last year the economy grew by 3%, despite half the country being in rebel hands. In delight, foreign donors pledged aid worth more than $2.5 billion. But diplomats in Kinshasa are beginning to sound queasy. The president's friends, they say, are becoming a problem.

Mr Kabila would rather discuss the election he promises to hold. His party is already holding rallies, even though other parties are forbidden to do so. Elections are hard to imagine, however. Fighting still rages in the east, and the country has virtually no infrastructure. In remote areas, people have returned to nudity

for want of clothes. But if Congo is to be put together again, an election will have to be held.

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Namibia

For whom the builders toil

Nov 13th 2003 | WINDHOEK
From The Economist print edition

Will Namibia's president, Sam Nujoma, retire on time? Maybe yes, maybe no

BUILDERS toil away at a new presidential palace in Windhoek, Namibia's capital, but President Sam Nujoma says it is not for him. The constitution obliges him to retire by March 2005, when the next presidential election is due. Opponents fear he may be going to rewrite the constitution and stay in power. “Some people are demanding it, but I don't think I want to do it,” Mr Nujoma told the *New African* magazine. “I must give the chance to the young people who have the strength to run the country.”

He has had the constitution changed before, though—in 1999, to allow him to run for a third five-year term. His party, the South West African People's Organisation, has three-quarters of the seats in parliament, enough to do it again. And Mr Nujoma is strikingly popular. A survey last year found that two-thirds of Namibians trust him. Some northern tribal leaders say he should stay. The foreign minister, Hidipo Hamutenya, a likely successor, says he is “convinced” that Mr Nujoma will go, but diplomats offer even chances that he will hang on.

When he rails against foreigners and homosexuals, Mr Nujoma can sound disagreeable. He tolerates sycophants, too: the state fund for promoting locally made films recently decided that the project most deserving of its backing was one based on Mr Nujoma's autobiography, “Where Others Wavered”. But his record is otherwise not bad. Namibia is stable, fairly democratic and has a nicely growing economy. Unlike, say, Robert Mugabe, Mr Nujoma fears no prosecution if he retires. Despite the allure of the new palace, there's a reasonable chance he'll make a graceful exit.

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European economies

A hitch to recovery

Nov 13th 2003
From The Economist print edition

The euro-area economies are reviving at last. But a strong currency may yet set them back again

THE economies of America and Japan have picked up speed recently; now the euro area seems to be following in their wake, albeit more sluggishly. After three consecutive quarters of decline, Germany's GDP rose by 0.9% at an annual rate in the third quarter of the year. France's rose by 1.6%. Growth for the euro area as a whole is likely to have been only slightly higher, well below America's stellar 7.2%.

So far, this has been yet another year of disappointment for Europe. Last December the euro-area economy was widely expected to grow by 1.5% in 2003; the latest estimate from *The Economist's* poll of forecasters puts it at only 0.4%. In contrast, America and Japan are now forecast to grow by 2.8% and 2.6% respectively, faster than originally expected.

The fourth quarter may produce a stronger performance. Recent business indicators suggest that a bigger rebound is under way; several confidence surveys have surged upwards. J.P. Morgan Chase now forecasts that GDP in the euro area will grow at an annual rate of 3% in the fourth quarter—the fastest for over three years. But that may still lag America.

One popular explanation for the euro economies' relatively poor performance is that companies have been slower to cut costs and repair their finances. Corporate America has certainly moved faster. However, the American economy has also had a helping hand from big interest-rate and tax cuts. The European Central Bank has moved less than the Federal Reserve. And although Germany, France and Italy are all breaching the 3% ceiling on budget deficits set by the EU's stability and growth pact, fiscal policy in the euro area will be slightly contractionary in both 2003 and 2004.

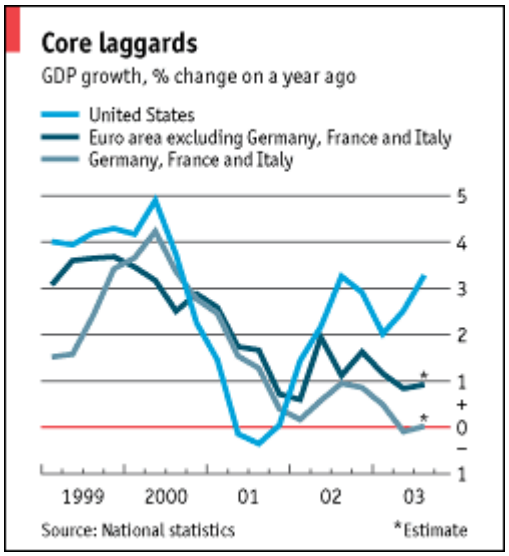
Some economists argue that America's economy has such huge imbalances that its recent rapid growth will prove unsustainable. It certainly looks more precarious than Europe's. America has a current-account deficit of 5% of GDP, whereas the euro area has a surplus. America's budget deficit (including state and local governments) will be close to 6% of GDP this year, twice as big as the average in Europe. American consumers save only 3% of their incomes, and they have debts amounting to 85% of GDP; euro-area households put aside more than 10% of their incomes, and their debts are only 52% of GDP.

These differences suggest that a recovery in the euro area might prove longer-lasting than in America. David Owen, an economist at Dresdner Kleinwort Wasserstein, points out that consumer spending in Europe, unlike America, has stagnated over the past couple of years, leaving big pent-up demand for consumer durables such as cars and electrical goods. Once consumers' confidence picks up, there could be a sharp rise in spending.

Another difference between America and Europe is that, during the slowdown, employment has held up better in the euro area than in America. Critics say this is further evidence of inflexible European labour markets, as it reflects the difficulty firms have in laying off unwanted workers. Yet it may also testify to a newly emerging flexibility, after recent reforms. Deregulation to permit more part-time work and short-term contracts, and tax changes to reduce labour costs, have all made output more job-intensive. So firms have hired more low-paid, low-productivity workers. One short-term cost is slower productivity growth than in America. But in the longer term, as more people enter the labour market, there should be permanent uplift for Europe's economies.

The reforms being painfully pushed through by the Chirac and Schröder governments in France and Germany should improve their countries' longer-term performance. But in the short run, there is also a risk that greater uncertainty caused by cuts in unemployment benefits and more job insecurity may cause households to save more and spend less.

Any analysis of growth in the euro area conceals as much as it reveals: differences within Europe are larger than differences between the euro area and America. In the year to the second quarter, for instance, GDP grew by 4.5% in Greece, but fell by 2.3% in Portugal. Over the past couple of years, growth has been consistently slower in the big three countries, Germany, France and Italy, than in the smaller ones (see chart). But even the smaller economies now disappoint. The Netherlands, once a star performer, has seen output fall by more than Germany over the past year. Ireland's growth has slumped to 2.1%, from 7.5% a year ago; Finland's has slowed from 4% to 0.8%.



Spain has remained the fastest-growing of the larger economies, but it is now looking especially vulnerable. Eric Lonergan, an economist at Cazenove, argues that Spain's growth is increasingly based on a housing bubble and excessive borrowing. If house prices falter, spending could slow. And although Spain makes up only 9% of euro-area output, it accounts for more than one-fifth of the growth in consumer spending over the past 12 months.

A bigger threat to the whole of the euro area is a stronger currency. The euro has eased against the dollar recently, but it is still up by 35% over the past two years. America's current-account deficit suggests that the dollar has further to fall. And because most Asian governments are resisting a sharp rise in their currencies, the burden of adjustment could fall on the euro. Economists at Citigroup estimate that a 5% rise in the euro's trade-weighted value reduces euro-area GDP in the following year by up to 0.5%. It would be ironic if Europeans who have hailed their new currency's ability to look the dollar in the eye now find that it clobbers their best chance of catching up with America's star.

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Italian politics after Nasiriya

The opposition finds its man

Nov 13th 2003 | ROME
From The Economist print edition

Silvio Berlusconi may be vulnerable to a rejuvenated Romano Prodi

Get article background

THE suicide bombing of a *carabinieri* headquarters at Nasiriya in Iraq has stunned Italy. Twelve paramilitary policemen and four soldiers died, along with two Italian civilians, in Italy's worst single military loss since the second world war. Silvio Berlusconi, the prime minister, requested a political truce while the grieving continued. For as long as it lasts, he will be the main political beneficiary. But he may well then suffer an "Iraq effect" not unlike the one plaguing Britain's Tony Blair. Unlike Britain, Italy did not contribute troops to the war; but Mr Berlusconi strongly backed America's policy and was eager to contribute to the post-war reconstruction effort. Now the body-bags are returning to a country whose public has been far more solidly opposed to military involvement than Britain's.

Reuters

Romano lends Silvio his ear, for now

Opposition politicians have been audibly grinding their teeth in their eagerness to capitalise on Mr Berlusconi's discomfort. They are more cocky now that they seem to have found the leader they have lacked since the centre-right's victory two years ago. A document issued this week, in Italian, by Romano Prodi, the president of the European Commission, was universally seen in Italy as a draft manifesto suggesting that he might contest next June's European elections as leader of the centre-left. If he did, Italy's role in the world might be at the centre of the debate.

Mr Prodi's document, entitled "Europe: the dream; the choices", depicts a peace-oriented foreign policy as inherently European and deplores the emergence of America as lone superpower. Distinctly more left than centre in tone, it also contains good green intentions, a commitment to a minimum wage and a hint that he might reverse the trend towards reduced state involvement in the economy.

Mr Prodi may be seen in Brussels as a second-rate president, but at home his stint as the European Union's most public figure has given him an air of authority that he could exploit to the full in campaigning. And if he succeeds in giving Mr Berlusconi a bloody nose in June, he could give him another at the general election due before 2006. After all, he has already done it once, in 1996.

A commission spokesman flatly denies that Mr Prodi might step down before his term of office runs out in October 2004. But everything suggests that Mr Prodi has indeed decided to fight Mr Berlusconi again, if

not next June, then at the general election. And the weapons he will use are curiously similar to Mr Berlusconi's.

One thing that propelled the media tycoon to power in 1994 was the impression he gave of being above day-to-day politics. He announced his decision to stand in a video recorded in his luxurious study and graciously donated to television channels for transmission. By making his first moves from distant Brussels, Mr Prodi has achieved something of the same detached effect. Then, in 2001, Mr Berlusconi led a highly personal campaign. His candidates were banned from putting their faces on posters: only pictures of the eternally tanned and smiling leader would do. The less charismatic Mr Prodi is going in the same direction: the word is that his grouping may be called the “pro-Prodi list”.

But should Mr Prodi, in his present job, be intervening so blatantly in Italian politics at all? The European Parliament's president, Pat Cox, has already asked for an explanation. Last week, Mr Prodi publicly clashed with Mr Berlusconi, who holds the EU presidency, for defending Russia's Vladimir Putin at the EU-Russia summit over Chechnya and the Yukos affair. If Mr Prodi emerges as the Italian prime minister's rival at home, his motives in such rows are bound to be questioned.

And what if he is forced to act sooner than he expects? Mr Berlusconi has problems in his own coalition, notably with the Northern League. Some on the centre-left think he may call a snap election next year. If Mr Prodi jumped ship early from Brussels, he might lose the aura of Euro-credibility that is his greatest asset in Italian eyes. That might be incentive enough for his rival to advance the elections.

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Germany's far right

Raus

Nov 13th 2003 | BERLIN
From The Economist print edition

The Christian Democrats eject a right-wing extremist

FINALLY. On November 10th the Christian Democrats moved to expel Martin Hohmann, a far-right backbencher, from the party. Almost two weeks had elapsed since it emerged that he made a speech in early October arguing that Germans should no longer be treated as a "guilty people" because, by the same logic, Jews should fall into this category as they played a prominent role in Bolshevik atrocities.

It is the delay in ousting the source of such anti-Semitic views that has raised most concern. But coming at the same time as a Eurobarometer poll showing that 59% of Europeans see Israel as a threat to world peace, the affair has led to some broader soul-searching.

Although most of the German elite was unanimous in condemning Mr Hohmann, he received some support, notably in a letter from Reinhard Günzel, commander of Germany's special forces, who was later sacked. Even more worrying, the speech, delivered to some 120 people in Mr Hohmann's constituency, caused a stir only after it was later found on the internet by a Jewish woman in America. Wolfgang Benz, head of the Berlin Centre for Anti-Semitism Research, says this is the first time in post-war history that a "coherent anti-Semitic argument" has been presented by a politician from a mainstream party.

Yet Mr Hohmann's ouster could be seen as encouraging. It shows that he and his like are on their way out of the Christian Democrats. The party has traditionally been a broad church that has accommodated the far right. Mr Hohmann's predecessor in his parliamentary constituency was a leader of a group known as the *Stahlhelm* fraction, known for its diehard nationalist views.

Pushing such people out of the party carries a risk, and not only in lost votes for the Christian Democrats. It could help a far-right party to gain momentum. Hence comments by Angela Merkel, the Christian Democrat leader, that may sound strange to foreign ears. She wants to stop national conservative voters being discredited, by drawing a clear line between them and Mr Hohmann. Christian Democrats, she thinks, still need to be able to say "we are proud of our country"—without lapsing into extremism or anti-Semitism.

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Nordic alcohol policies

Viking binge

Nov 13th 2003 | COPENHAGEN AND STOCKHOLM
From The Economist print edition

How Europe's single market makes boozing cheaper

THE alcohol stores in Helsingor struggle to close on time, as Swedes cram in to grab a few more bottles before heading back across the Oresund strait that divides these Nordic neighbours. Trade in the stores has doubled since Denmark cut taxes on spirits by 45% at the start of October. Its action is inexorably chipping away at the entire Nordic region's restrictive alcohol regime.

The Danish government, itself trying to discourage people from heading across the border to Germany to buy cheap booze, felt it had no choice. Even after the tax cut, the incentives for drinkers to go abroad are powerful. A bottle of Bells Extra Special Scotch, priced at NKr270 ($38) in Norway, can be had for NKr225 in Sweden, NKr117 in Denmark and just NKr90 in Germany.

Sweden is deeply worried. In the 19th century, a lethal cocktail mixing the misery caused by industrialisation with cheap spirits helped to set off endemic alcohol abuse. Total prohibition was only narrowly defeated in a referendum in 1922. Alcohol was rationed until 1955. Strong beer, wine and spirits remain heavily taxed, and retail sales are still conducted through a limited number of state monopoly stores. Similar systems exist in Finland and Norway. Temperance movements have a strong political foothold in all three Scandinavian countries.

Since their entry into the European Union in 1995, Sweden and Finland have struggled to protect their alcohol regimes, as import restrictions have been gradually lifted under single-market rules. In Sweden consumption has risen to levels not seen since 1875. Hakan Leifman, a researcher at Stockholm University, says Swedes over 15 now consume around ten litres of pure alcohol a year, still well below the 14-15 litres per year in Ireland, but closing in on the EU average of 12. Other measures aimed at limiting sales have also fallen foul of EU rules. Earlier this year Sweden's ban on the advertising of strong beer, wine and spirits was overruled.

So far there is little evidence of a more “sophisticated” European attitude to alcohol: “binge drinking” remains the Scandinavian way. Public-health organisations are alarmed, predicting a rise in alcohol-related violence, drink-driving and chronic alcohol-related diseases.

But with Swedes in the south of the country bringing in booze from Denmark, and a virtual scrapping of controls on such imports coming in January, Bosse Ringholm, the (teetotal) finance minister, faces a dilemma. Even Sweden's state alcohol stores are campaigning for a tax cut. If Mr Ringholm does not oblige, he will lose revenues and foster an environment for illegal reselling. But if he does, cheaper alcohol will be available throughout the country. The Finnish prime minister, Matti Vanhanen, is duly proposing steep tax cuts in January, in an effort to stem imports.

Similar arguments are being heard even in non-EU Norway. The country has maintained its import control of one litre of spirits per person. But since it has scrapped most of its border checks, Norway has now become a nation of petty smugglers. Few expect the prime minister, Kjell Magne Bondevik, a teetotal Lutheran priest, to jump at the idea of a tax cut. Some have suggested that the answer is to reimpose border controls. But if the Swedes do cut prices it will be hard for Norway to stand against the tide. One way or another, cheaper alcohol is coming.

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French corruption

Elfs and dwarfs

Nov 13th 2003 | PARIS
From The Economist print edition

The last verdict in the Elf trials

IF THERE was a sense of déjà vu about the verdicts this week in France's Elf corruption trial, it is because investigations into the former state-owned oil company have creaked along for over nine years. But there was nothing humdrum in the judgment: five years behind bars for the top pair, Loïk Le Floch-Prigent, boss of Elf in 1989-1993, and Alfred Sirven, his deputy; four for their ex-"Mr Africa", André Tarallo; and prison sentences (some suspended) for 27 other accused, as well as combined fines of nearly €20m ($23m).

The case grew out of attempts to nail top figures for corruption at Elf under President François Mitterrand in the early 1990s. Most famously, Roland Dumas, a former foreign minister and head of France's constitutional council, was cleared on appeal. But the case against his former mistress, Christine Deviers-Joncour, whose book about the events was entitled "The Whore of the Republic", was upheld. So were those against Mr Le Floch-Prigent and Mr Sirven, who are already in jail.

In the latest (and last) Elf case, the former businessmen were accused of operating and benefiting from slush funds to the combined tune of some €305m. At first, the trio insisted that they were operating an inherited *système Elf*, designed to further French oil policy and to benefit certain African leaders. Thus, the swanky Paris apartment that he acquired, insisted Mr Tarallo, was for the use of Gabon's president, Omar Bongo. A magnificent villa in Corsica was intended to house a "Franco-African foundation".

By the end, however, such defences crumbled. Mr Sirven, who fled to the Philippines (and swallowed the chip in his mobile phone) before his arrest, turned on his former boss. He had spent over €100m on Mr Le Floch-Prigent's behalf, he said. This included such acquisitions as a sumptuous $9m house in Paris that Mr Le Floch-Prigent had termed a "business flat". A picture emerged of an extraordinary world of bribery and personal profit, of jewellery and fur, villas and mistresses.

One conclusion from this case might be that all French corporate practices are irredeemably corrupt. Certainly, Elf is not alone in being investigated. Possible American criminal charges hang over Crédit Lyonnais, a French bank, in relation to its purchase of Executive Life, an insurance company, in 1991. Official investigations are still going on into Jean-Marie Messier, former head of Vivendi, who steered the French media conglomerate to the edge of bankruptcy last year.

More plausibly, though, the Elf trial may show that French justice is at last getting to grips with corruption. Many recent cases relate to a former era. These include the trial of Alain Juppé, head of the ruling Union for a Popular Movement, and others over "fictitious jobs" for party workers at the Paris town hall, in which a verdict is due in January. New party-financing rules are supposed to make such practices obsolete. At the least, French prosecutors are no longer shy of fingering top businessmen or politicians. With one big exception: the only figure protected from prosecution while in office is the man who was in charge of the town hall as mayor, President Jacques Chirac.

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Russia's need to belong

Seal of disapproval

Nov 13th 2003 | MOSCOW
From The Economist print edition

Internal affairs are making Russia less welcome in global clubs

RUSSIA, unlike Groucho Marx, will join any club that will have it as a member. Pulling his weight internationally has long mattered to President Vladimir Putin. He fought in vain to keep the Iraq war under the control of the UN Security Council, where Russia has a veto. He is pushing to get Russia into the World Trade Organisation. He wants to join the OECD rich-country club. And by hosting the G8 summit in 2006, he hopes to put the seal on Russia's membership of the most elite club of all.

Responses to the arrest of Mikhail Khodorkovsky, of the Yukos oil firm, do not augur well. “The Russian government is not behaving in a manner that qualifies it to belong in the club of industrialised democracies,” said John McCain, an Arizona senator. Richard Perle, an *eminence grise* of American defence, called for Russia to be kicked out of the G8. Chris Patten, the European commissioner for external relations, said the case could slow Russia's integration into the European economic area.

Such comments may not change much in Moscow. But the American presidential campaign is aligning groups in Washington that are unhappy with Mr Putin. A small but influential crowd dislikes his anti-democratic tendencies and post-imperial habit of meddling with his neighbours. Human-rights activists fret over Chechnya; last month's rigged election for the republic's president has drawn more flak. The often heavy-handed treatment of non-Orthodox Christian minorities upsets the religious wing of the Republican Party.

All of which means, says an American official, that “for the first time in two-and-a-half years, there is the potential for Russia policy to become politicised.” Negotiations over WTO membership, to which all existing members must agree, “will be more complicated”. And it is “almost inconceivable” that Congress will repeal the Jackson-Vanik amendment, a Soviet-era restriction on trade.

The biggest obstacle to WTO membership, though, is the European Union, which gets 20% of its natural-gas supplies from Russia. There is a stalemate over the fivefold difference between Russia's domestic and export prices for gas. The EU first demanded that Russia abolish the gap, then that it liberalise its gas market and break up the state monopoly. Russia condemns such demands as meddling in internal affairs. A recent EU-Russia summit concluded that Russia might enter the WTO by the end of next year—an unrealistic goal, says Al Breach of Brunswick UBS Warburg, but also a sign that “it's a deal ultimately about money...and they're edging towards an agreement.”

Yet patience with Russia may be wearing thin. The EU summit communiqué omitted any mention of human-rights abuses in Chechnya because, says one EU official, Mr Putin insisted that it mention also the supposed abuse of ethnic Russians' civil rights in Latvia. He also hinted at a trade-off between gas prices and the Kyoto Protocol on global warming, which Russia has not ratified. “The Russians are very good at linking two unrelated issues in a negotiation,” notes the official.

Mr Putin's insistence at the summit that there was no political motive for Mr Khodorkovsky's arrest was implausible. It will not have helped other goals, such as visa-free EU entry for Russians. Not that there is much sympathy for Mr Khodorkovsky, the richest of Russia's early capitalists. But all big clubs will now look more critically at Mr Putin's membership aspirations.

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Lithuania's embattled president

Dropping the pilot

Nov 13th 2003 | RIGA
From The Economist print edition

Rolandas Paksas is under growing pressure to quit

AFP

Paksas prepares to pack

“NO, I will not resign,” President Rolandas Paksas of Lithuania insisted this week, after less than a year in the job. The former Soviet stunt pilot may change his mind. An official report linking people around him to influence-peddling and organised crime has left him looking careless, at best, in his choice of advisers.

A dossier given to parliamentary leaders by Lithuania's security services says that Mr Paksas's national security adviser, Remigijus Acas, was one of several senior figures acquainted with a reputed Russian organised-crime boss, who was keen to expand his interests in Lithuania. Another close associate, said to have links to the illegal arms trade, allegedly threatened to make Mr Paksas “a political corpse” after he failed to get a government job in return for a big campaign donation.

Mr Paksas has suspended Mr Acas, who denies wrongdoing. A parliamentary investigation has begun. Some commentators speculate about a presidential impeachment, though the grounds remain unclear. The public prosecutor may question the president next week. Mr Paksas sees a “conspiracy” against him, and perhaps against Lithuania's plans to join the EU and NATO.

As a right-wing president, he can expect little sympathy from a left-wing parliament. But this scandal owes little to domestic politicking. Arturas Paulauskas, the speaker of parliament, says it was caused partly by tip-offs from foreign intelligence services, who are keen to see Lithuania clean house before joining NATO. They have a point. The president decides foreign policy, chairs the defence council and is commander-in-chief of the armed forces. Better, perhaps, if he is not a friend of a friend of a reputed Russian mafia boss.

Much turns on what Algirdas Brazauskas, Lithuania's left-wing prime minister, says. His tone, neutral at first, has grown steelier. A reshuffle of presidential advisers, set in motion this week, may no longer be enough, he has said. He is waiting to see if “new facts” emerge that might “implicate the president directly”. Mr Brazauskas may once have thought that a weakened president would suit him. But the likelier it is that Mr Paksas will go, the less profitable it will be to stand by him.

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Charlemagne

Europe's rebellious regions

Nov 13th 2003
From The Economist print edition

Why the ambitious regions of Europe have lost faith in Brussels

AS JORDI PUJOL, the gnome-like but powerful boss of Catalonia's government, paces his office in his medieval palace in central Barcelona, he does not look like a man on the brink of retirement. But on November 16th, after 23 years in office, Mr Pujol will leave the stage. He has every reason to feel satisfied. He survived imprisonment by Franco in the 1960s, to see fascism fall in Spain and self-government return to Catalonia. The Catalan language has revived and Barcelona has become one of the most fashionable cities in Europe. Yet Mr Pujol does not seem relaxed. He fears that the Spanish government is trying to roll back some of the hard-won powers of regions such as Catalonia and the Basque country. But, he says, the Catalans (and Basques) want more, not less, autonomy. The next few years, concludes Mr Pujol, will be “a critical period”.

What happens in Catalonia is of more than local interest. Europe's nation-states are being challenged from above, by the growing powers of the supranational European Union, but also from below, by increasingly assertive regions. Some theorists talk of a new layering of power in Europe. Although national governments continue to dominate such things as the organisation of welfare states, on bigger issues like trade, the environment or monetary policy it is the EU that nowadays decides. But in such matters as education, cultural identity or economic regeneration it is Europe's regions that are coming to the fore. This symmetrical squeeze on the nation-state sounds appealingly neat in theory. But, as the controversies in Catalonia show, the reality can be a lot messier. Across Europe, governments and regions still squabble over how power should be distributed.

Thus in Germany, the only big west European country with a long-established and reasonably settled federal system, the regions (*Länder*) complain that their powers are being simultaneously eroded by Brussels and Berlin. In France, the government is committed to decentralisation, but its devolution plan for Corsica was messily rejected in a recent referendum. In Italy, the Northern League, which wants more political and economic power for the north of the country, is threatening to bring down the coalition government of Silvio Berlusconi unless regions are given more clout. In Britain, Tony Blair's government set up a Scottish Parliament and a Welsh Assembly in its first term in office; it is now, somewhat reluctantly, adding elected assemblies for some of the regions of England. In Belgium, Dutch-speaking Flanders continues to demand ever-greater autonomy from the rest of the country.

Where does the EU fit into this back-and-forth struggle? Many European regionalists have long seen it as a natural ally against the centralism of nation-states. In Scotland, nationalists have seized on the idea of Scotland's European vocation as a way of counteracting the idea that independence might lead to isolation or poverty. Visitors to the office of John Swinney, head of the Scottish Nationalist Party, find two flags prominently displayed, Scotland's cross of St Andrew and the yellow stars of the European Union. Elsewhere, however, regionalists are beginning to have their doubts about Brussels.

Thus Mr Pujol, a passionate “pro-European” for all his political life, now believes that “the EU is no longer encouraging regionalism”. Efforts by Catalonia, Scotland, Flanders and the German *Länder* to have a bigger role for regions written into the draft of the new EU constitution were rebuffed by the convention on the future of Europe, partly thanks to pressure from Spain and France. The Committee of Regions, based in Brussels and headed by the suitably named Sir Albert Bore from Birmingham, England, is a byword for tedium and toothlessness. Its weakness owes something to its unbalanced nature: genuine powers, such as Mr Pujol's Catalonia or Edmund Stoiber's Bavaria, sit alongside feeble local councils from Britain and Sweden.

The enemy in Brussels

Some regional enthusiasts now see the European Commission as an enemy. The *Länder* complain loudly that EU competition rules are eliminating their traditional practice of dishing out aid to local industries. In Italy, Umberto Bossi, leader of the Northern League, who once saw the EU as an ally in his struggle against the Italian state, now dismisses it as a plaything of big government, multinational corporations and paedophiles. The League, whose attempt to preserve the cultural purity of northern Italy (Padania) has entailed virulent anti-immigrant rhetoric, fears that the EU is trying to impose political values that may lead to a direct clash with the aims of the party.

The European institutions in Brussels have reasons of their own to be wary of regionalism. On a theoretical level, Eurocrats may be attracted by the idea of a layering of levels of political power (with the EU naturally at the apex). But the commission dare not overtly encourage regionalist ambitions, for fear of antagonising powerful member governments. And, as one official points out, “it's already a nightmare trying to secure agreement between 15 member states, and it's going to get worse after enlargement to 25. It will be totally impossible if we have to deal with more powerful regional governments as well.”

The expansion of the EU is undoubtedly contributing to the feeling of rebelliousness in the European regions. Some new member countries, such as Malta and the three Baltic states, are both smaller and poorer than such regions as Catalonia or Flanders. Mr Pujol admits that it has been a “psychological shock” to see these midgets take their place at the EU's top table, while Catalonia must content itself with being represented by Spain. He wants Catalan to become an official working language of the EU, pointing out that it is more widely spoken than several others. But Mr Pujol still stops short of demanding that Catalonia take its place in the EU as an independent country. Whether his successors will be as moderate is an open question.

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Police reform

Hard to turn the coppers round

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From The Economist print edition

Reuters

Making the police answer to local people sounds good. But how to do it?

IT IS the hot new idea: local services ought to be accountable to local people. And everyone seems to agree that the police are a public service ripe for reform. Combine the two, and you get the government and both main opposition parties all pushing the same way, for local oversight of the men in blue. The Liberal Democrats aim, vaguely, to put them under regional control; the Conservatives want neighbourhood sheriffs. Labour proposes elected “police boards” and community advocates to keep chief constables on their toes.

Such ideas used to be strictly for radical leftwingers. Now even coppers are talking the talk. “We need to go much more local, much more accountable,” Sir Ian Blair, deputy commissioner of London's Metropolitan Police, said last month.

The strangest convert to this new consensus is David Blunkett, the usually authoritarian and centralist home secretary. His change of heart may result from exasperation. Since coming to power in 1997, the government has poured money into policing. Crime has fallen steadily; the chance of falling victim to it is the lowest for more than 20 years.

Yet people still aren't happy. Public confidence in the police has declined, along with confidence in the courts. Before the Conservatives, still generally viewed as the party of law and order, start benefiting from this discontent, Mr Blunkett wants to channel it into closer ties with local bobbies. He may also hope that (as Tim Newburn, a criminologist at the London School of Economics, puts it) the public will turn out to be “mini-Blunketts” who will drive the police as hard as he does.

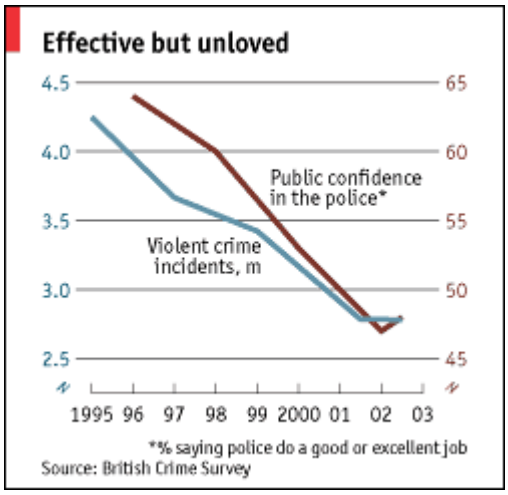
Handing the reins to the public would reverse a centuries-long drift towards centralisation. The present government has accelerated this, setting numerous crime-reduction targets and, last year, demanding weekly briefings on street crime.

For all the hand-wringing about lost police independence, it is public involvement that has suffered more. The chief outlets for local views nowadays are police authorities, which are made up mostly of councillors and magistrates. They help set budgets and outline general priorities. But few people have heard of them; when told, they aren't impressed.

What, then, of the government's plans? The police authorities are against the idea of direct elections; so is Mark Oaten, the Lib Dems' home affairs spokesman, who rarely sees a bit of grassroots democracy that he doesn't like. Mr Oaten says there is a danger that racists and other zealots will be elected. He

also argues that the people most in need of better policing (ie, the inhabitants of crime-plagued housing estates) are least likely to vote. As so often with public services, the greatest benefit may go to the middle classes.

Tentative efforts to give people a say in how they are protected seem to bear out this gloomy assessment. Opinion polls show overwhelming support, in principle, for more policemen on the beat. But put into practice, results have been mixed. One peaceful north Yorkshire housing estate recently paid for its own uniformed copper, only to find that he spent much of his time off the beat. Following an initial dip, crime actually doubled, satisfaction in the police fell from 31% to 22%, and the contract was cancelled a year early. That suggests that local control and more police are only partial answers; more important is dealing with abysmally low police productivity, paperwork that clogs up the system, and incompetence in other parts of the criminal justice set-up.



It may be, too, that police reformers are trying to appeal to the wrong bit of “the public”. Everyone wants the police to be more chummy with respectable citizens; yet it is the poor and feckless who have the best insights into crime. The benefits of that approach are well demonstrated in Chicago, where monthly “beat meetings” (which are explicitly aimed at gathering information from locals) are particularly well attended in crime-blighted black neighbourhoods. Crime rates there have fallen; but, unlike in Britain, the police are held in ever greater esteem.

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Business gripes (1): regulation

Red tape, blue moods

Nov 13th 2003 | BIRMINGHAM AND LONDON
From The Economist print edition

Business discontent with regulation (and tax—see article) is growing. How serious is it—and could it offer a chance to the Tories?

Get article background

IT IS the most pro-business Labour government ever. Both Gordon Brown, who runs Britain's finances, and Tony Blair, the prime minister, will speak at the Confederation of British Industry (CBI) conference in Birmingham next week.

In the past they have had a warm welcome. Business still thinks well of Mr Brown's macroeconomics. He and the prime minister speak enthusiastically about enterprise. And though there are moans about red tape, Mr Blair has made ministries conduct a “regulatory impact assessment” of all measures they propose. There is a cabinet-office unit to chivvy them. A given minister is responsible for regulation in each big department. A task force of business people helps them all.

What more do companies want? Results, comes the reply, especially from small firms, which cannot afford armies of experts in health and safety, environmental or employment law. Whitehall goes through the motions, says Ian Brough, from the Black Country Chamber of Commerce, but it's “a charade”.

The number of rules, their complexity and their costs, in time and money, are multiplying. The West Midlands' best-known property developers, Don and Roy Richardson, say 50 years ago, 15% of their time went on the bureaucracy of their trade; these days it is more like 75%.

Why the ever-louder complaints? The bosses blame a flood of European Union directives, made even more stringent when turned into British law and regulations, and applied relentlessly. For manufacturers, the Health and Safety Executive (HSE) is the regulator they love to hate. Its inspectors are few, but annoying. To take just one example: your lorry is delivering rods to a building site. Its driver cuts the steel bands circling the bundles of rods for a fork-lift truck to offload them. Stop, says the HSE inspector, both drivers must stay in their cabs, while a third man, trained to cut bands, cuts them.

Not that safety rules are always wrong: “We've always done it that way” is to blame for countless accidents and unhealthy working conditions. But the rules, says David Grove, president of the Birmingham Chamber of Commerce (and owner of the aforementioned lorry), “are written as if we were all raving idiots”.

Moreover, they are fiercely applied. This is not the case in competing European Union countries, the business lobby complains. One source compares the stern safety regime in a (now closed) Midlands tractor plant with the way workers wander over the moving assembly line in a sister plant in France.

Environment law too bites hard. The EU wants pollution stopped before water reaches the reservoir, rather than having the stuff clean in pipes. Fine, says a water-company boss, but “how far do you go? It's stopping the last 10% that eats 90% of the cost.” Tightened rules on contaminated land are another bugbear, though business did fight off an idea to force company accounts always to reflect the cost of returning every site to a pristine state.

The CBI's biggest regulatory beef is labour law. Some is justified, says the director-general, Digby Jones, but it all adds to costs. Long maternity leave dissuades at least some firms from hiring young wives. The possible end to Britain's opt-out from EU working-time rules is a nightmare for firms working odd hours. The cost of complying may be less than the cost of checking compliance; a hotel in Dudley had to hire an extra person just to record the irregular hours worked.

What is to be done? One idea is better consultation. Using a Whitehall website to invite opinions is no way to ensure they arrive. Few small firms will notice; not all business bodies are good at telling them. Yet even if that works, says Andrew Sparrow, of Birmingham Forward, a lobby group, the views of business “tend to vanish into the ether”.

A chance, then, for the Conservatives? “Business is out of love with Labour, but not yet in love with us enough,” says John Redwood, a former industry minister. The Tories like to allege that red tape costs £6 billion ($10 billion), and pledge both to slash it and fight in Brussels against more. But in the past, “they were no better,” says Mr Brough. To most bosses, so far, regulation remains a battle with Brussels and Whitehall, not with any party.

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Business gripes (2): tax

Tax tussles

Nov 13th 2003
From The Economist print edition

Taxes on business have risen. But not as much as the CBI claims

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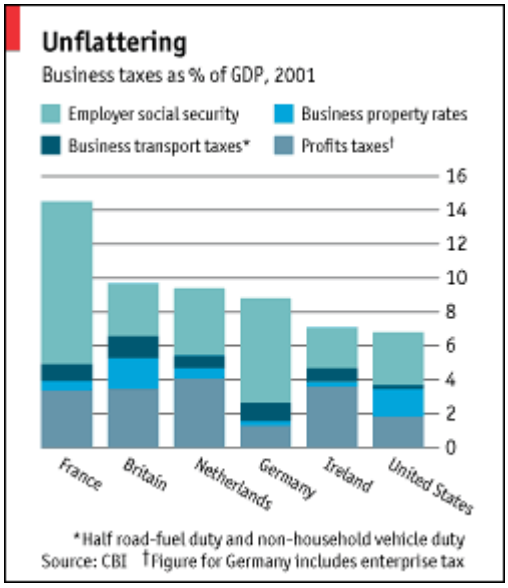

WHO'S right? The Confederation of British Industry (CBI), in a broadside fired before its conference next week, claims that the business-tax burden in Britain is higher than in four of the country's top five trading partners (see chart). Only French companies have to shoulder a bigger load, it complains. Yet the government thinks companies are whingeing and exaggerating as usual.

The CBI's definition of the business-tax burden is certainly suspect. It includes not just corporate-income tax, but also three other taxes—on property, transport costs and employment. Most of the latter three are likely to be passed on respectively to landowners, consumers and workers, argues Stephen Bond of the Institute for Fiscal Studies. For example, this year's hike in employers' national-insurance contributions (in effect a payroll tax) may initially erode profitability, but in the long term employers will shift the cost on to workers through lower wage increases.

Ignoring these three taxes, the government's case looks stronger. Profits in Britain are more lightly taxed than in the Netherlands; the overall burden on companies is broadly comparable with France and Ireland. The apparently low tax take in Germany mainly reflects the temporary effects of fiscal reforms there as well as the fact that a high proportion of German businesses are unincorporated.

The CBI also claims that the business-tax burden has increased sharply since 1997 as a result of Gordon Brown's budgets. In making this claim it includes the chancellor's raid on pension funds in 1997, which has extracted about £5 billion a year from dividend income. The employers' organisation estimates that business has had to pay £5.6 billion a year more in taxes in the six years to 2002-03; and that it will pay an extra £6 billion ($10 billion) this financial year.

The Treasury retorts that the main corporation-tax rate in Britain has been cut from 33% to 30%, the lowest-ever level. Together with reductions in tax rates for small companies, these cuts are now costing the exchequer about £4 billion a year. Mr Brown has also helped businesses by introducing tax credits for research and development, worth £600m this year.

Who's right, then? The Institute for Fiscal Studies agrees that business taxes (including the higher taxes from dividend income) did indeed rise sharply in the past six years. Companies paid an average of £4.8 billion more a year, not far short of the CBI's estimate. But the IFS also says that the extra burden has fallen this year to £1.4 billion because the Treasury is no longer benefiting from the transitional effects of switching corporation-tax payments to quarterly instalments. This estimate is much less than the CBI's £6 billion claim, mainly because the IFS does not include this year's increase in employers' national-insurance contributions.

The CBI says that the tax burden is now set to rise in Britain, whereas in the country's other main trading partners it will not. However, this worry is based on the Treasury's projections in the April budget of a substantial upturn in corporation-tax revenues. Many economists think this prediction is unrealistic.

It is no accident that the business-tax estimates throw up such distorted and varying estimates. Ultimately, it is individuals that pay tax, as consumers, wage-earners, savers and so forth. But they complain more if the tax bill is presented directly, rather than disguised in higher prices, lower wages or whatever. The muddle over who really pays business taxes suits chancellors like Mr Brown who want to raise extra money without too much fuss. But he should not complain too loudly when businesses play equally fast and loose with the numbers.

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Transsexuals

Right cross

Nov 13th 2003
From The Economist print edition

A tweak in the law for a small but vulnerable minority

WHEN Queen Elizabeth lists the new bills her government will introduce at the state opening of Parliament on November 26th, the “gender recognition bill” may provoke a few smirks. Why, many may wonder, does the government need a law to decide what sex someone is? And does it really justify the expected cost to the taxpayer of £340 ($570) that bureaucratic recognition of each switch will cost?

Such smirking would be as unkind as talk of “genderbenders” is pejorative. The country's 5,000 transsexual people will find their lives made easier by the new law. Along with Ireland, Albania and Andorra, Britain is one of the few European states that does not give transsexuals legal recognition of their new gender. This creates problems: a transsexual woman may take out car insurance under her new name, but if she has a crash she risks prosecution for driving without insurance and fraud. The other option is to take out insurance under her original male identity. But that means a regular risk of embarrassment—for example when producing documents.

The same problem arises when transsexuals apply for those jobs, often in public services, which require an original birth certificate as proof of identity. That same document determines what is written on marriage certificates too. Since a legal ruling in a colourful divorce case in 1970, transsexuals have been unable to marry, bringing criticism from international human rights outfits.

Changing sex, which involves therapy, medication and surgery, costs £15,000 if paid for by the NHS (less by the speedier private route). In three out of four cases, the change involves men becoming women.

The new law would set up a “gender recognition panel”. Applicants will have to prove that they have lived in their new gender for at least two years and that they intend to live that way until death. This last point might be tricky: between 2% and 5% of those who change sex eventually revert to their original state. Legal recognition will mean a new birth certificate and the right to civil (but not church) marriage.

Lynne Jones, a Labour MP involved in the issue, says there has been “a sea change” in parliamentary attitudes to transsexuals. She expects cross-party support for the bill.

But writing laws on identity is a tricky business. For those who married before changing sex, legal recognition will depend on divorcing first. And the new law will do nothing for those who undergo the lengthy process of “transitioning” only to end up feeling they belong to neither gender. Even the most sympathetically drafted law cannot cope with that.

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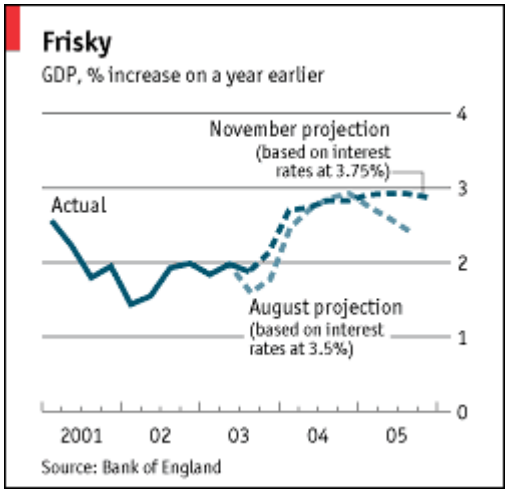
The economy

Higher growth, higher rates

Nov 13th 2003
From The Economist print edition

The Bank of England has signalled further increases in the cost of borrowing

Get article background



HAVING raised interest rates last week for the first time in nearly four years, the Bank of England this week set out its latest views on the economic outlook. The quarterly *Inflation Report* suggests that more pain lies ahead for borrowers.

The Bank has become notably more upbeat about the prospects for growth. It expects the economy to expand by nearly 3% next year. Unlike in its August report, it thinks that the economy will continue growing at this rate in 2005.

The reasons for the change of mind are domestic. Although the American economy is now bowling along, the euro area has been weaker than expected. That means that the overall outlook for Britain's export markets has deteriorated a little. But the growth outlook for consumer spending is now higher than projected in August. The prospects for business investment have brightened, too; the Bank is forecasting that this will grow over the next two years in line with GDP.

Spurred by domestic demand, the economy will therefore be expanding faster than its trend growth rate of around 2.5%. This will not stoke inflation as long as the economy has some spare capacity. But Mervyn King, the Bank's governor, does not believe there is much slack to be absorbed. For example, the latest figures show that the unemployment rate is 5%, much lower than a few years ago. So above-trend growth will start to generate inflationary pressures by 2005.

Indeed, the Bank expects inflation will remain at or above the 2.5% target over the next two years. At present, over half a percentage point of inflation, currently 2.8%, stems from rising house prices. The Bank expects house prices to be flat in two years' time, so a reduction in the contribution from housing costs will be offset by other sources of inflation.

One worry is that higher rates will tip the housing market over the edge. However, Mr King says that households are less likely to fall into “negative equity”, where their homes are worth less than mortgage debt, than a decade ago. Then half of new loans were worth over 90% of the value of homes; now only a fifth are. This means that a repeat of the misery of the early 1990s is much less likely.

The Bank's new forecasts suggest that rates will continue to increase next year. Futures traders in the City expect the base rate, now 3.75%, to reach 5% by the end of 2005. But so big a rise may not be needed if the housing market responds swiftly to the turn of the interest-rate cycle.

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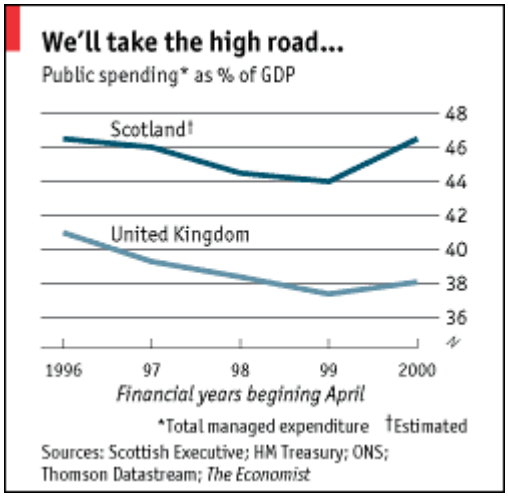
Scottish economy

Piped lament

Nov 13th 2003 | EDINBURGH
From The Economist print edition

Scotland's bloated public sector crowds out growth. Where's the axe?

AN UNEXPECTED ray of economic sunshine broke across Scotland on November 10th with a survey showing the orderbooks of local business swelling faster than at any time in the past three years. It seemed like great news for the hard-pressed political hacks who run Scotland's devolved assembly. Since the creation of the Scottish Parliament in 1999, a near stagnant economy has dashed once rosy expectations of prosperity. But actually, the news is not that good, and it increasingly looks as if local politicians are the problem, not the solution.



The survey, a purchasing managers' index published by the Royal Bank of Scotland, showed that the current upturn, caused mainly by the American economy picking up, is actually bigger everywhere else in Britain. So Scotland, where the economy has grown by only 14.5% since 1995 compared with 23% in Britain, is still lagging behind.

Why? One reason is that manufacturing (especially electronics) and farming have been hurt especially badly in the past few years. They are bigger parts of the Scottish than the British economy as a whole. But given the national reputation for canniness, drive and thrift, Scots still ought to be doing a lot better.

In fact, much of this reputation has been earned abroad rather than at home. A recent book* by Tom Devine, professor of Irish and Scottish Studies at Aberdeen University, has shown that even in boom times, Scots emigrated in droves in search of better opportunities abroad. Many founded or ran great commercial empires, such as Jardine Matheson in Hong Kong. They still want to go. A recent MORI poll found that a third of 17-25-year-olds would emigrate given the chance.

The problems of the enterprising leavers and the slow-growing stay-behinds has caused much head-scratching. Strathclyde University has invited some of the world's leading economists to suggest solutions. One, William Baumol, a professor at New York University, argued that the "availability of lucrative positions in the governmental bureaucracy serves to attract away many individuals with entrepreneurial talent from roles that could contribute to the economy's production."

He has a point. Public spending in Scotland consistently consumes getting on for 10% more of the Scottish economy than in Britain generally and is fast approaching 50% of GDP (see chart). It does seem to be crowding out private activity—public sector employment is 27% of all Scottish jobs, but 24% of all British jobs. Donald MacRae, chief economist at Lloyds TSB, a bank, reckons that this reduces the incentive for private business. The business birth rate in 2002, at 28 per 10,000 Scots, is way below the British rate of 37 per 10,000, and self-employment is similarly low.

Yet few politicians favour the obvious remedy. Only the Conservatives, a minority in the Scottish Parliament, advocate privatisation and the contracting-out of public services. They would be even more unelectable if they dared to promise cuts in public spending.

*"Scotland's Empire, 1600-1815". By T. M. Devine. Allen Lane, £25.

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The Conservative Party

Team Howard

Nov 13th 2003
From The Economist print edition

Halved in size, will the new shadow cabinet be twice as good?

WITH ruthlessness and courage, Michael Howard has picked the team of colleagues he expects to take the fight to the government.

To rebuild the party's run-down and clunky machine, Mr Howard has split the chairmanship between Liam Fox, his most trusted lieutenant, and Lord (Maurice) Saatchi, the adman who helped shape Margaret Thatcher's election campaigns. Lord Saatchi will both sharpen the party's message and open the wallets of business supporters who, in recent years, have been reluctant to throw good money after bad. Dr Fox, a former health spokesman who is clever, energetic and highly ideological, will ginger up the activists. But unless there is agreement about who does what, the relationship could prove volatile.

If running Conservative Central Office needs two people, Mr Howard thinks education and health—the public services on whose condition the next election may depend—can get by with just one. The Tory leader has decided to halve the shadow cabinet's size, to 12, of which only seven have departmental responsibilities. He hopes this will create a more cohesive and instantly recognisable top team. But he may have gone too far.

Tim Yeo, a moderniser who has been given the combined health and education portfolio, will struggle to master briefs which are complex and divergent. That is not the only drawback. Mr Yeo has two subordinates who will do much of the work at the House of Commons coalface. But their positions are ambiguous. The “shadow secretary of state for health”, the able Andrew Lansley, will be in the peculiar position of reporting to Mr Yeo rather than Mr Howard. On the other hand, it is hard to imagine that the unimpressive Tim Collins would have been given the equivalent job covering education were he not to be kept well out of the limelight. It is unsatisfactory and confusing.

That said, the new appointments do honour Mr Howard's commitment to lead from the centre of the party. Several of Iain Duncan Smith's weirder chums have been shown the door, while David Curry, a close ally of the Europhiles' champion Kenneth Clarke, has been brought into the shadow cabinet to oversee local government. An arch-progressive, John Bercow, who resigned in disgust over the previous leadership's opposition to adoption by homosexual couples, is back; there is no formal place, at least for now, for the right-wing and brainy John Redwood.

Mr Howard's most intriguing choices are Oliver Letwin as shadow chancellor and David Willetts as head of policy co-ordination. An early task for the wonkish “two brains” Mr Willetts could be to find a way out of the ill-judged pledge to abolish university tuition fees.

Mr Letwin is as intellectual as Mr Willetts and more charismatic, although occasionally gaffe-prone. By pitting him against Gordon Brown, Mr Howard is testing him, perhaps to destruction. But if Mr Letwin discomfits the chancellor as regularly as he did the home secretary, David Blunkett, he will be hard to beat when the 62-year-old Mr Howard eventually steps down.

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Judges

Bench press

Nov 13th 2003
From The Economist print edition

Lord Falconer says he has no intention of undermining the judiciary

JUDGES and the government have “the same view” of judicial independence, says Lord Falconer, the secretary of state for constitutional affairs. “It has got to be defended...it is one of the cornerstones of the constitution.” His emollient language contrasts with the charge levelled by the Lord Chief Justice, Lord Woolf, that the judiciary is facing the worst threat to its independence for 400 years. The government is pleading “not guilty” to that, in a way that, despite the furore, suggests no constitutional crisis is imminent.

The trigger for the row has been the government's abrupt decision to abolish the role of Lord Chancellor without knowing what to put in its place. Lord Falconer says he has an open mind on the key issues of judicial independence—appointments, discipline, deployment, and training. “I want to have as much agreement with the judges as possible,” he insists.

The biggest unresolved dispute is the criteria for appointments. The government wants the principles for selection, such as diversity and expertise, to be enshrined in legislation. The judges say that this would let a future government create a judiciary in its own political image. A further, unexpressed concern is that allowing the government to meddle in appointments would lead to a bench stuffed with poorly qualified women and ethnic minority candidates. Lord Falconer dismisses such fears as “entirely theoretical”. The government and the judges, he says, should sit down together and settle their differences. “When you look at the details, we are not as much at odds as the reporting suggests,” he claims.

A sensible sit-down will be tricky, though, because the judiciary does not speak with one voice. Some judges agree that the government should have a say in judicial appointments, particularly at a senior level. Others take the view that any ministerial involvement at all would undermine the judiciary's independence.

Lord Falconer claims that the new appointments system will work better if both the judiciary and the executive have a stake. It is a view shared by constitutional experts. Jeffrey Jowell, professor of public law at the University of London, says: “You have got to have some sort of political buy-in to the system.” Even if the details remain to be agreed, that conclusion is likely to be accepted by the judges. Neither the judiciary nor the government wants this to escalate. Both have much to lose.

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Bagehot

It's personal

Nov 13th 2003
From The Economist print edition

Dealing with Gordon Brown and George Bush are Tony Blair's two toughest tasks

IT'S hard not to feel a pang of sympathy for Tony Blair. Here he is trying to get on with running the country and making the world a safer place. But his two most vital relationships in those twin endeavours bring him nothing but trouble and strife. Most of last weekend was spent clearing up after the trail of destruction that the chancellor, Gordon Brown, left on his rampaging return from paternity leave. Mr Blair will spend most of this weekend trying to limit the damage that President George Bush's arrival on these shores next week seems certain to do him.

Most—although not quite all—of the similarities end there. Mr Brown sets out to make mischief for the prime minister because, basically, he wants his job. Mr Bush, it is safe to say, is not hoping to swap the White House for Downing Street. Nor does he want to hurt his friend. The harm he does Mr Blair is a largely unintended consequence of who and what he is. The two relationships do, however, have something in common other than their centrality to Mr Blair's political fortunes. Both throw up issues that, in the past, Mr Blair would have finessed or glossed over. Now, however, he has made up his mind to confront them.

As far as Mr Brown is concerned, matters have reached a critical point. Although the tensions between the prime minister and his chancellor have provided the mood music for much of Labour's six-and-a-half years in office, there were ground rules that both men, until the end of last week, respected.

Whatever their differences, the principal protagonists did not air them in public. The battles were fought by proxies. Acolytes on either side briefed and spun on behalf of their masters. But Mr Blair and Mr Brown always had the cover of plausible deniability. They could claim that the gossip and rumour surrounding their relationship was just that.

Like his speech to the party conference in late September lauding traditional Labour values, Mr Brown's lambasting of the draft European Union constitution in the *Daily Telegraph*, the house journal of the Tory party, was a barely veiled attack on the prime minister. Tendentious though the article was, it kept, just, within the bounds of propriety.

What did not was Mr Brown's appearance on television a day or so later, telling bewildered viewers how miffed he was not to have been given a place by Mr Blair on Labour's National Executive Committee. Once upon a time, this body had a crucial role in writing the election manifesto, but Mr Blair has steadily reduced its influence. Mr Brown's purpose, it seems, was to make sections of the party cross with Mr Blair for slighting him. But why did Mr Brown decide to take such a fateful step now?

He is clearly livid that his old enemy, Peter Mandelson, appears restored, albeit informally, to the prime minister's right hand. But it is also likely that he sees the next few months as the period of greatest risk for Mr Blair before the next election. Foundation hospitals, university tuition fees, mounting pressure for a referendum on the EU constitution, Lord Hutton's report and more setbacks in Iraq will all test Mr Blair's resolve.

Mr Brown may be calculating that if it all becomes too much for Mr Blair that his desire to continue will weaken. But Mr Blair's resolve is far from fading. If anything, the knowledge that he will have to raise his game to see off the challenge presented by the Tories' new leader, Michael Howard, has increased it. So has Mr Brown's decision to go public with his resentments.

The prime minister is more certain than ever that it is his choice-driven agenda for the public services rather than the more centralising approach of Mr Brown that will see off the revitalised Tories—and most

Labour MPs reluctantly agree. Those close to Mr Blair say that if Mr Brown wants an argument, he can have one. They are now confident it is a tussle the chancellor can't win. The only question is whether Mr Brown recognises it and backs off before his position becomes untenable.

He's my buddy

With Mr Bush, by contrast, the problem for Mr Blair is that the relationship is too good. If the early indications are accurate, the president's forthcoming state visit will be a politically torrid affair. Many of the up to 2m Britons who took to the streets last February against the war in Iraq are expected to sally forth again. Although they will describe themselves as anti-war, they are, above all, anti-Bush. A Populus poll carried out for the *Times* this week found that half the British public believe that the closeness of the two men has been bad for Britain.

Helped on by a spate of condemnatory newspaper articles and routinely apocalyptic reporting on television news bulletins, it is widely accepted that Iraq is a mess created by American arrogance and incompetence. This is increasingly combined with a patronising subtext that things would be going much better if only the Americans had heeded both British advice and the wiser tactics employed in the British zone of occupation.

Under the circumstances, Mr Blair could be forgiven for hoping that Mr Bush does the decent thing and comes down with a dose of diplomatic flu. In fact, nothing could be further from his mind. In a forceful speech on foreign policy earlier this week, Mr Blair said: “I believe this is exactly the right time for him to come.” Despite initial mistakes and the poor security situation in Iraq, he believes the coalition allies now have the right policies and are making progress in implementing them. He has a weekly video conference with Mr Bush and says that they are thinking on exactly the same lines.

The prime minister is fed up with the prevailing pessimism over Iraq and has been frustrated that the Hutton inquiry and the arguments over missing weapons of mass destruction have deflected attention from what he sees as more important issues. He is neither going to apologise for Iraq nor for his friendship with Mr Bush. In short, he is ready for a fight on this as well.

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Trade wars

Sparks fly over steel

Nov 13th 2003
From The Economist print edition

Getty

The looming trade war over America's steel tariffs may yet be averted thanks largely to an expected surge in global steel prices

Get article background

ON NOVEMBER 11th the World Trade Organisation (WTO) ruled definitively that America's so-called "safeguard" steel tariffs were illegal. The first response from the White House was defiant, but by mid-week it became clear that the Bush administration was in two minds about how to proceed. If it did not relent, Europe's response would be to slap retaliatory duties on $2.2 billion of products ranging from motor boats and sun glasses to textiles and orange juice. Its choice of targets is designed partly to serve Europe's own domestic interests by avoiding areas where it relies on American produce and, secondarily, to hurt producers in ways likely to do maximum damage to George Bush in next year's presidential election (see article).

The administration has not reaped the benefits it expected from the introduction of tariffs in March 2002. The Institute for International Economics (IIE) in Washington, DC, calculates that the cost to steel users so far has been about $600m in lost profits from higher prices and 26,000 lost jobs. That dwarfs the benefit to American steel firms, which the IIE reckons has been only $240m, mostly from a 3.3% rise in average steel prices, with some 5,000 jobs saved. (America's International Trade Commission, which argued for the tariffs, disagrees about the price effect, saying they have raised prices by only 0.94%.)

The president has a number of options. Scrap the tariffs, and hope that the net benefits of trade will somehow tally with the electoral arithmetic. Defy the WTO and face retaliation from the European Union and seven other countries. Or find a third way that placates both the domestic steel industry and foreign steel exporters. One possibility is to reduce tariff rates and increase exemptions. Another option is more devious: eliminate the tariffs but keep some of the protection they offer by changing America's anti-dumping rules. Firms now subject both to safeguard tariffs and anti-dumping duties would instead simply face higher anti-dumping duties. Anti-dumping duties are levied retroactively. The money collected would even go to America's steel industry. The impact on European producers would be severe. Corus, an Anglo-Dutch group, says it would mean an anti-dumping duty of 50%.

The main argument of steel consumers is that they should not be denied cheaper foreign steel at a time when, for instance, Detroit's car industry is under intolerable pressure from Japanese, European and

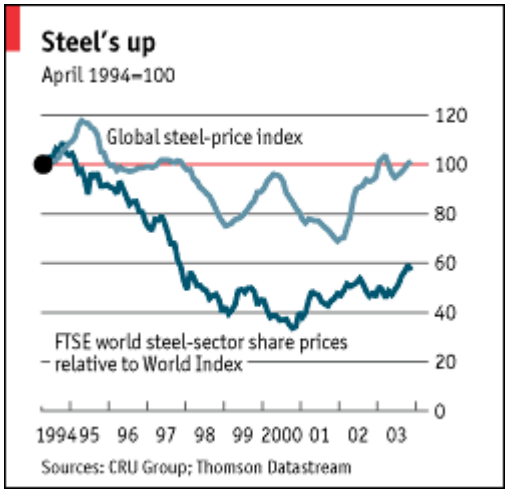
South Korean competitors. The companies that stamp out parts for cars from flat steel fear that continued upward pressure on their input prices will simply accelerate the trend for carmakers to seek more supplies of basic metal parts from distant, cheap-labour countries such as China.

Steel crazy after all these years

Those who want the tariffs to stay in place argue that the steel industry has been consolidating very effectively in recent years and that it deserves further protection to allow it to carry on its rationalisation and introduction of more-flexible labour practices. Wilbur Ross, the chief executive of International Steel Group (ISG), is an entrepreneur who has moved aggressively into steel by buying bankrupt companies and distressed assets. ISG has snapped up failing firms such as LTV, Acme and Bethlehem Steel. The latter was particularly burdened with pension and health-care costs for retired workers. Multiple rounds of job cuts had left it with seven pensioners per employee. With these costs offloaded on to a federal body, Mr Ross went on to transform the economics of steelmaking in traditional integrated plants, thanks to radical deals with the United Steel Workers of America. The union was surprisingly keen to do a deal with anyone who could save members' jobs.

A rival consolidator, US Steel, has snapped up the assets of National Steel. The mini-mill Nucor steel company, which revolutionised the industry by making advanced slab-steel cheaply from electric-arc furnaces fed on scrap metal, has bought the mills of Trico Steel and Birmingham Steel. Mr Ross argues that more consolidation is needed, and that continued tariff protection for another year is the way to make sure it happens.

Gary Hufbauer and Ben Goodrich of the IIE argue the opposite. They note that most of the consolidation so brilliantly effected by Mr Ross and others has come from failing firms selling out to bigger companies under the threat of bankruptcy, mostly before the tariffs were introduced in March last year. Keeping the steel tariffs in place, they suggest, would simply mean sustaining higher prices for a while longer and enabling weak firms to stagger on for a few more years. Mr Ross himself concedes that one consequence of scrapping the tariffs would be more mill closures, which rather proves his opponents' point.



But there could be relief on the way for America's mills—and, indeed, for President Bush—from an unlikely source. As the chart shows, world steel prices are rising. The reason is not so much American tariffs as China's insatiable appetite for raw materials and basic products such as steel. According to World Steel Dynamics (WSD), a research firm, last year China accounted for 31% of world steel consumption of 936m tonnes; 14% of which was imported. This was sharply up from 20% of the world total of 780m tonnes in 2001. The price of imported sheet-steel sold to China has risen from $240 a tonne to over $300, while Chinese domestic steel prices have risen by a fifth in the past year.

WSD is now forecasting a shortage of steel in the first quarter of next year, noting that by this summer the world's mills were running at 95% of capacity. As well as China's appetite for imported steel there are worries about shortages of raw materials, such as the coke and scrap iron needed in steelmaking. WSD thinks there is a strong chance of the biggest price spike since the mid-1970s. True, Asian relief would not last for ever. China is investing heavily in expanding its own steel capacity. Sooner or later much of that will flood on to world markets. But in the meantime, higher prices may give Mr Bush a win-win opportunity: to please domestic steel consumers and shock his foreign critics—who love to cite his steel policy as evidence of his arrogant unilateralism—by scrapping the tariffs, without doing much damage to what remains of America's steel industry. Go for it, Mr President.

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Music mergers

Come together

Nov 13th 2003
From The Economist print edition

Desperate, music firms are pairing off

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"A DESPERATION merger in a fading industry," is how Tyler Cowen, an American economist, describes the plan announced by Sony and Bertelsmann on November 6th to combine their music businesses in a joint venture. Music executives prefer to talk of synergy, rationalisation and strength through partnership. But the fact is that big music firms are in deep trouble because sales are falling fast; merging is one of the few things they can think of doing. Selling up altogether may appeal even more—as Vivendi, a French conglomerate, until recently hoped to do with its Universal Music Group, the biggest music firm. Time Warner is expected to announce soon the sale of all or most of its Warner Music Group.

Time Warner could sell this to Haim Saban, a media entrepreneur, and Edgar Bronfman, a former owner of Universal Music Group, who both have cash from private equity firms. They are thought to be primarily interested in the music-publishing part of the business, which is not afflicted to the same degree as recorded music, but they would buy the entire business if they could get it cheaply enough. Otherwise Time Warner could choose EMI, a British firm with which it had planned to combine its music arm in 2000—only to be thwarted by the European Commission on antitrust grounds. For months, Time Warner and EMI have been fashioning a fresh deal in which EMI would give Warner cash and a minority stake in the merged business.

Music executives wonder whether Sony's and Bertelsmann's announcement, which was about nothing more than a non-binding letter of intent, was designed simply to spoil things for EMI and Warner. The top five music companies have 83% of the music market in America, 78% in Europe and 75% globally, according to Sanford C. Bernstein, a broker. Competition authorities, particularly the trigger-happy European Commission, may argue that reducing their number further would hurt consumers, especially since they have been found guilty in the past of colluding to keep prices high. One merger might sneak through; two will probably not.

The firms will argue that they face new and powerful competitors in the guise of digital pirates—as well as Wal-Mart, which plans to sell music cheaply online. Because of piracy, says one leading competition lawyer in Washington, DC, she is optimistic that even two mergers—both Sony/Bertelsmann and Warner/EMI—could be allowed. In the coming months, senior music executives may spend as much time hyping up the harmful effects of piracy on their business as they will fighting it.

Mergers would allow music companies to cut their costs further, cushioning their profits against falling revenues for a while. Analysts think that a merged EMI-Warner would extract $150m-300m of cost savings a year. But consolidation will do little to solve their biggest problem, which is that their customers are deserting them for free-music downloads on the internet, cheap bootleg copies, and for other forms of entertainment. Combining departments will not help them, for instance, to get better at finding new artists—a role cornered in recent years by small independent labels, whose sales are rising as those of big firms fall. At worst, merger deals will tie up management's time resolving antitrust issues and clashes of corporate culture at a moment when a much more urgent issue must be addressed: how should the recorded music industry change in order to survive?

People outside the industry have plenty of answers to this question. Some say it needs to cut CD prices to compete with the roughly $5 cost of pirate copies; others that it should put far more resources into building legal alternatives to peer-to-peer file sharing—along the lines of iTunes and Napster 2.0, but cheaper. Costs are still bloated in the music industry, says Sarah Simon, media analyst at Morgan Stanley in London, and cost reductions far deeper than those envisaged in merger scenarios should be

made. For now, big music will put its energies into shrinking to as few players as possible. But soon it will need a new tune.

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Antitrust and Microsoft

Windows of opportunity

Nov 13th 2003
From The Economist print edition

Microsoft's legal battles, continued

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AP

Grrr!

IS THIS the endgame? Microsoft's antitrust battles in court and with regulators seem to have been dragging on forever. But they may now be entering their final stages. Though focused on narrow issues, how these battles play out will still have big implications for the firm and the software industry as a whole.

This week, the European Commission held closed-door hearings on whether the giant American software firm abused its dominant position in personal-computer operating systems in two ways: by failing to provide smooth interoperability with server software from rival firms and by tying its Windows Media Player to its operating system, thus extending its dominance into an adjacent software market. A week earlier, an appeals court in America heard arguments by the state of Massachusetts and two trade groups that the punishments imposed on Microsoft last year fail to protect consumers from further anti-competitive behaviour.

Both cases spring from the belief that Microsoft has faced penalties, but not remedies. In both, there are two main issues: the alleged need for greater disclosure of technical information so rival products have an equal chance of working well with Microsoft's operating system. Second, how to resolve the perceived problem of “co-mingling” software code—that is, integrating bits of software from an application such as a web browser or media player into the operating system. Though Microsoft says this practice leads to greater functionality for users, its rivals say it gives Microsoft an unfair advantage, helping it to expand into other products.

On the latter, the solution agreed in the American case that is now being appealed is to allow PC makers and users to remove the icon for Microsoft applications, but not the underlying software. The objection to this approach is that, although it can superficially give competing products a vaunted place on the PC screen, it does not alleviate a deeper concern that the mere presence of Microsoft's software provides an incentive for the wider industry of developers and content providers to use it.

The European Commission could yet impose far tougher sanctions on Microsoft than America has done. European antitrust law allows violators to be fined as much as 10% of annual revenues worldwide. Furthermore, two proposed remedies the commission says it may choose from are the removal of co-mingled software code, and a “must carry” provision for all new PCs to carry the media software products of rivals alongside Microsoft's.

If Microsoft loses in America, this would not unravel previous settlements with the federal government and many states. Instead, the matter would return to the district court for additional remedies to be placed on Microsoft. It could try to challenge new remedies all the way to the Supreme Court. Likewise, if Europe imposes remedies Microsoft dislikes, it can appeal at the European Court of First Instance in Luxembourg, which has overturned several antitrust decisions. The endgame may yet take a long time ending.

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Mergers and acquisitions

The dominator

Nov 13th 2003 | FRANKFURT
From The Economist print edition

Buyers in Germany, beware

ACQUIRERS of German firms may think they have a done deal, only to find themselves snared by a technicality. Consider the experience of Procter & Gamble. In September, the giant American consumer-goods firm spent €4.7 billion ($5.3 billion) to buy Wella, a German maker of hair-care products, in what looked like a straightforward deal. But this week, a group of investors in Wella tried for the seventh time to get more money for their non-voting preference shares.

P&G has offered them €65 a share while paying voting shareholders €92—an unfair differential, they say. Now they want an extraordinary general meeting, alleging that P&G is treating Wella as a wholly-owned subsidiary when it holds only 79% of its total shares. To exercise full control, P&G should enter a "domination agreement" (*Beherrschungsvertrag*) with minority shareholders, they argue. Such an agreement usually means paying a higher dividend or more cash: it could cost P&G up to €460m extra, they estimate.

P&G shows no signs of budging. Legal advice, and previous rulings by BaFin, the German financial watchdog, encourage the firm to believe that it behaved correctly and paid enough—indeed, it paid over the legal minimum, which is the average price for the previous three months. Moreover, these minority shareholders are speculators, say sources close to P&G: "one of them is a hedge fund, Elliott Associates, which bought into the deal after it was announced". Another, however, is Deka, the fund-management arm of the nationwide savings banks system and no fly-by-night.

Domination agreements are quite common. Vodafone struck one with remaining Mannesmann shareholders during its takeover in February 2000. Volkswagen has a domination agreement with the rump shareholders of Audi. P&G's original offer allowed for the possibility of an agreement, but it was advised that it could get away without one.

The Wella preference shareholders doubt that P&G can achieve its goals for Wella without full-scale integration.

P&G hit another local snag last month in its talks to buy Beiersdorf, the Hamburg-based maker of Nivea. Its overtures were pre-empted by a deal worth €4.4 billion that put Beiersdorf into the hands of Tchibo, another Hamburg firm. The deal only succeeded because minority shareholders were denied a full tender offer, as Tchibo's original 30% stake in Beiersdorf predated Germany's new takeover code. Lawyers advised Tchibo and other parties to the takeover that a full tender would not be required.

Now some minority shareholders are challenging that assumption. Deminor, a Brussels-based activist group has sent a letter to BaFin suggesting that the deal—in which the city of Hamburg's investment fund and, strangely, Beiersdorf itself, agreed to buy most of Allianz's 40% stake in Beiersdorf at a premium—was a case of "acting in concert". If BaFin rules that they did act in concert, a full tender offer would be necessary. Even Deminor admits that the decision could go either way in this highly political takeover.

In a replay, Tchibo could probably not afford a full tender, meaning that Beiersdorf would be a target again, perhaps for an older and wiser P&G. But until these points of German corporate law are clarified by BaFin decisions, or by fresh case history, potential buyers should beware the power of the minority.

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Telecoms and airlines

Parallel lines

Nov 13th 2003
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How instructive are the similarities between telecoms firms and airlines?

THERE'S no business like show business, supposedly—but might there be a business like telecoms? It has become fashionable to suggest that there is, and that valuable lessons can be learned by comparing telecoms, a turbulent industry beset with crisis and opportunity, to another business also in turmoil: air travel.

Both industries consist of carriers serving routes on a global network. Both were dominated by state-owned monopolies that have now mostly been privatised, but remain sources of national pride.

In both cases, market liberalisation has let in new entrants. The incumbents jealously guard their inherited access rights—local-loop copper lines in the case of telecoms and landing slots for airlines. Airlines, like telecoms firms, can concentrate on local or long-distance routes, or appeal to specific markets, such as cost-conscious consumers or business customers. And in both industries there is massive overcapacity on some routes, with empty seats on planes and fibre-optic cables unused.

Another striking parallel is evident in Europe's mobile-phone industry, now organised into three camps, like airline alliances. These groupings want to provide easier roaming between mobile networks in different countries—equivalent to airline “code-sharing” partnerships.

The analogy is not perfect, of course. Henry Elkington of Boston Consulting Group points out that telecoms networks are fixed to the ground but planes can be moved to a profitable route. Quite so. But the analogy is strong enough to be useful. After years of relying on specialist consultants, says David Newkirk of Booz Allen & Hamilton, “we are now seeing the telecoms market look outside itself for lessons”. And it is often to air travel.

The two industries do differ in one crucial respect: the incumbent airlines have been undermined by a new wave of “low-cost carriers”, such as Southwest Airlines, that are now more profitable and valuable. These airlines are innovative: selling tickets online, using a single aircraft type to cut maintenance costs and scrapping assigned seating. They also open up new markets.

Some observers believe the telecoms industry could be ripe for a similar transformation. “The telcos have yet to face competitors with a disruptive power analogous to the low-cost air carriers,” says Vasa Babic of Mercer, a consultancy. “I believe there is scope for such disruption.”

What might a low-cost telecoms carrier look like? One example, suggests Mr Babic, is Telmore, a Danish mobile operator. Like many low-cost airlines, it offers a basic service and primarily deals with customers over the web. It has no high-street shops, nor does it own a network; it resells airtime on a network owned by TDC, Denmark's incumbent. Customers check their balances via text messages. There are no subscription fees or paper bills. Since its launch three years ago, Telmore has captured 7% of the Danish market with a model so potentially threatening that TDC bought a stake in the firm earlier this year.

Incumbents could also be undermined by operators, such as Vonage and Net2Phone, which offer low-cost calls routed over broadband internet connections. Vonage, for example, provides unlimited calling within America and Canada for $34.99 per month. It keeps costs down by handling billing, voicemail and other services online, and by outsourcing and partnering where possible.

The difficulty for would-be low-cost telecoms firms, says Andrew Heaney of Spectrum, a consultancy, is that the incumbents still own the wires that run into homes and offices. Low-cost airlines got around the lack of landing slots by flying from secondary airfields. Telecoms incumbents are supposed to provide

access to their local loops to competitors, but most find procedural, legal and technical reasons for being slow about it. So telecoms regulators need to do more to ensure equal access for new entrants, says Mr Heaney.

Meanwhile, the new mobile-telephone alliances hope to learn from airline alliances as they shift from national to international competition, says Mr Newkirk. The bifurcation of the air-travel industry, between low-cost online sales to consumers and high-end consultancy services for business, might also provide a model. “There's no single way to apply the analogy,” he says. Perhaps it will inspire a new breed of telecoms firms. But it is also possible that, having been made aware of the threat, the telecoms incumbents will avoid the fate of their airline counterparts.

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Auction houses

Going

Nov 13th 2003
From The Economist print edition

Despite bumper sales, Christie's and Sotheby's are pursuing a risky strategy

AFTER their worst three years ever, Christie's and Sotheby's, the duopoly dominating fine-art auctions, insist that the worst is over. They have put most of their legal troubles behind them, cut costs and laid off staff. Phillips, de Pury & Luxembourg, an unwelcome interloper, has been reduced to little more than a glorified dealership. Last week's sales of Impressionist art in New York set record prices. This week's auctions of modern art had a terrific start too.

This will come as a relief. Christie's turnover fell by 17% and Sotheby's by 15% during the second quarter of the fiscal year, compared with the same period in 2002. Sotheby's lost $13.4m in the first six months of this year, though this includes restructuring costs and antitrust charges. Christie's, a private firm, does not release its numbers.

Perhaps art sales will continue to boom as economic confidence returns—and, if the rumours are true, those Russian billionaires who prefer buying art to soccer clubs continue to exchange ill-gotten cash for real assets. At Christie's Impressionist sale on November 4th, a sculpture by Henry Moore, a picture by Fernand Léger and even a portrait by Amadeo Modigliani that few consider a strong work by the Italian painter fetched the highest prices ever paid for work by each artist. Likewise, at the Sotheby's sale on November 5th, “The Villa at Attersee”, a 1914 painting by Gustav Klimt, went for $29m, a record for the Austrian artist.

Yet behind the scenes, both firms had more reason than ever to pray for success, due to their increasingly risky strategy of providing “guarantees”. These aim to attract big sellers of art by promising them a guaranteed minimum sum for individual works of art or entire collections, payable regardless of the auction outcome (plus a participation in the profit beyond a certain limit). These can certainly improve supply, but they are a gamble. Competition between the auction houses can drive up these guarantees to dangerous levels. Such guarantees played a significant part in the downfall of Phillips, which had to pay out tens of millions of dollars to sellers when numerous works failed to fetch as much as their guaranteed price.

How ironic that, having criticised Phillips at the time, both Christie's and Sotheby's are now competing with ever-higher guarantees of their own, in the manner of a losing gambler doubling up. In this round of sales, they got lucky. But it would not take many disappointing auctions for the cost of paying guarantees to blow a sizeable hole in their fragile finances. That would not make a pretty picture.

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Executive coaching

Corporate therapy

Nov 13th 2003
From The Economist print edition

Having an executive coach is all the rage

IT ALL sounds alarmingly like the process of self-criticism that kept Chairman Mao's China on the ideological tracks. Your company hires an outsider to grill your boss, your staff and perhaps even your spouse on the shortcomings (and strengths) of your behaviour. The outsider confronts you with the findings and together you draw up a plan for self-improvement. Your boss and staff undertake to help you to keep to the plan. From time to time, the outsider returns to check on how you are doing.

Yet top executives as self-confident as eBay's Meg Whitman and Unilever's Niall Ferguson have undergone “executive coaching”. This week the International Coach Federation (ICF), the largest trade group, is meeting in Denver for its annual conference. Its global membership has soared from about 1,500 in 1999 to almost 7,000 today. The coaching market is now worth around $1 billion worldwide, a number that Harvard Business School expects to double in the next two years. “It's going crazy,” says Brian Edwards of Optima, a British coaching firm that has been in business for five years.

Coaching might seem an obvious second career for a former chief executive keen to profit from a little mentoring. Though a few coaches are ex-bosses, most have other skills, according to the ICF's recently completed first survey of members. Two-thirds are women, it finds; a substantial minority come from teaching or counselling backgrounds. Others are former mental-health workers. Jeremy Robinson, a coach from New York, began as a psychoanalyst and often counsels clients partly on their work problems and partly on those in their home lives. Many such workers are seeking fresh pastures as tighter government budgets and the trimming of the amounts which insurance firms spend on clinical psychology have taken a toll on their employment prospects, argues Edgar Schein, of the Massachusetts Institute of Technology's Sloan School.

Some coaches come to the office. But half, according to the ICF figures, do their coaching mainly by phone. Val Williams, an independent coach who was once an executive at a big health-care group, coaches a client in Finland by telephone every month, discussing what progress he has made in meeting the goals he set himself during their previous conversation.

Like personal physical trainers, some coaches work for individuals. Ms Williams reckons that a quarter of her clients pay their own bills. Five years ago, however, three-quarters did. Increasingly, firms are willing to pick up the tab.

Shrink or swim

Often, coaching is a way to give problem employees one last chance. Mr Schein says it is easier for managers to hire a coach than to give an unsatisfactory employee a bleak performance appraisal.

And yet such “derailment coaching” is not much fun for coaches either, and it rarely achieves much, so the coaching industry is increasingly trying to accentuate the positive, even urging companies to use their services as a perk to retain high-fliers. Judging by how some American executives brag at dinner parties about their hot new coach, this strategy has potential.

Rohm and Haas, a specialty chemical company, picks half a dozen promising executives a year to go through a programme grandly called Leadership 3000. They undergo a battery of psychoanalytic tests, listen to feedback (“we like to call it feed-forward,” says Joe Forish, the firm's head of human resources) which the coach collects from colleagues and subordinates, and agree an action plan that is discussed with the firm's top executives as well as with the person's immediate boss. “We make it clear that this is

an investment in people's futures," says Mr Forish. At a cost of $15,000-20,000 for up to a year of the coach's time, an investment it clearly is.

Most coaches are one-man bands or tiny firms. But a few big human-resources consultancies are moving in: Hewitt Associates has teamed up with Marshall Goldsmith, a celebrity in the coaching industry, who has coached top executives at Boeing, Motorola and General Electric, and more than 50 chief executives. Together, the two have a network of about 200 coaches, all using a proprietary method developed by Mr Goldsmith. This allows them to win big contracts, such as a recent deal with one multinational to coach 200 of its top staff. The two brands spell higher charges: typically $30,000-70,000, and much more for Mr Goldsmith's personal services. But the venture also submits its bill only if the client agrees, a year after the coaching, that certain agreed goals have been met.

What does coaching actually achieve? Rigorous analysis of so touchy-feely an activity is probably impossible. Karol Wasylyshyn, a coach based in Philadelphia, has asked her clients to rate the "sustainability" of what they learned on a scale of one to ten. Over a third rate it nine to ten, she says proudly. However, this may reflect the attitudes of clients as much as real achievement. It seems that high-fliers compete as hard to improve their behaviour as in anything else. "They don't think I'm perfect? I'm gonna prove to them I am," mimics Marc Effron of Hewitt Associates.

Nevertheless, the perception of success may be as important as the reality. One reason why coaches strive to involve an executive's peers and boss at every stage is so that they, too, feel some responsibility for helping to bring about change. Not only does this reinforce a better approach; it may also persuade them that they are seeing the alteration they want to bring about.

The fact that the firm usually foots the bill for coaching has two big implications. First, says Mr Schein, it means that a lot of coaching is about "self-socialisation": getting the individual to conform to patterns of behaviour acceptable to the firm.

Then there is the issue of privacy. "I always tell people they have limited confidentiality," says Mr Robinson. Coaches may find themselves in an especially awkward situation if coaching persuades a client that the best way to develop his career is to quit the firm paying for the coach. Ms Wasylyshyn has formulated a way to tell the human-resources department that a high-flier she is coaching is restive, without breaching confidence. "I think you might lean in and do a reality check," she will say, with delicate circumlocution.

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Face value

The one-handed economist

Nov 13th 2003
From The Economist print edition

Paul Krugman and the controversial art of popularising economics

"GIVE me a one-handed economist," demanded a frustrated American president. "All my economists say, 'on the one hand...on the other'". From a mono-manual perspective, at least, Harry Truman would have loved Paul Krugman, an economist who rarely hesitates to take a bold position—even when the subject is himself. In recounting the transformation of his twice-weekly *New York Times* column from a genial discussion of the "New Economy" into a widely read broadside against the Bush administration, the Princeton professor recently described himself as "a lonely voice of truth in a sea of corruption."

What is beyond dispute is that Mr Krugman is the finest economist to become a media superstar—at least since Milton Friedman or, earlier, John Maynard Keynes turned to journalism. Mr Krugman's work on currency crises and international trade is widely admired by other economists. He holds the John Bates Clark medal in economics, which is slightly harder to get than a Nobel prize. As for popularity, his new book, "The Great Unravelling"—his eighth aimed at a broad, non-academic readership—has spent eight weeks on the *New York Times* bestseller list.

The Economist, which itself has been known on occasion to clamber off the economic fence, can hardly criticise anybody for writing hard-hitting (yet engaging and accessible!) economic analyses. But, increasingly, people are asking whether Mr Krugman's success as a journalist is now coming at the expense of, rather than as the result of, his economics. For while he has had some journalistic coups during his time as a columnist—most notably in recognising, long before most other commentators, that market manipulation played a role in the California energy crisis—perhaps the most striking thing about his writing these days is not its economic rigour but its political partisanship.

Lyinginponds.com, a website that tracks partisanship among American political columnists, rates Mr Krugman second in the overall partisan slant of his columns, behind only Ann Coulter, a fiercely (and often incoherently) conservative polemicist. As the site documents exhaustively, the vast majority of Mr Krugman's columns feature attacks on Republicans; almost none criticise Democrats. Unsurprisingly, this has made him a sort of ivory-tower folk-hero of the American left—a thinking person's Michael Moore. But he may have even more readers among his ideological adversaries, particularly on the internet, where deconstructing his latest column is a kind of twice-weekly parlour game—albeit one so contentious it has spawned talk-show chatter and even legal threats.

He refers to these critics as his "stalkers". Many of them spend an inordinate amount of time quibbling about minor semantic points, or trivial differences in statistics. But they cannot all be easily dismissed.

The more reasonable ones allow that he is a gifted writer and economist, but also argue that these days his relentless partisanship is getting in the way of his argument. Is the American political and economic picture, they ask, really as one-sided as he paints it? And if not, should an economist of Mr Krugman's prominence be telling the public that it is?

A glance through his past columns reveals a growing tendency to attribute all the world's ills to George Bush. Regarding California's energy crisis, for example, he berated the Bush administration and the Federal Energy Regulatory Commission for not imposing price caps sooner—but found no room to mention Bill Clinton, who presided over a similarly inactive FERC for the first part of the crisis, nor to attack California's then Democratic governor Gray Davis for his disastrous refusal to allow consumer prices to rise. After Mahathir Mohamad, the prime minister of Malaysia, recently gave an anti-Semitic speech, Mr Krugman argued that the Bush administration's ham-fisted foreign policy had forced Dr Mahathir to make the remarks in order to shore up domestic political support—most unlikely, given that he was about to step down.

Even his economics is sometimes stretched. A recent piece accused conservatives of embracing the “lump of labour fallacy”, the mistaken claim that there is a fixed quantity of work which governments must strive to allocate equitably. In fact, the paper he cited did not commit the lump of labour fallacy. He used game theory to argue that, by criticising North Korea but not attacking it, and then going after Iraq instead, Mr Bush is “probably” encouraging North Korea to become a more dangerous nuclear power. This probably did not convince most game theorists. Overall, the effect is to give lay readers the illusion that Mr Krugman's perfectly respectable personal political beliefs can somehow be derived empirically from economic theory.

No such thing as a free lunch

Now that he is a journalist, it is perhaps not surprising that Mr Krugman seems to have embraced the concept of the free lunch—even though as an economist he should know better. Every opportunity (including lunch, and even including Mr Krugman's favoured policies) has a cost. Decision-making, not least in politics, tends to be hard because it involves trading off those costs and benefits, with the resulting net gains often marginal and uncertain. Surely one of an economist's main tasks is to remind one-handed politicians, and their constituents, that economic choices generally come in shades of grey, not black and white—even when they are made by one's political rivals.

Many of Mr Krugman's fellow economists, jealous of his celebrity, comfort themselves with the thought that his angry rants have hurt his reputation enough to ensure he will not now win a Nobel prize. They may be kidding themselves. The Nobel committee has not been averse in the past to giving the prize to economists who have achieved popular notoriety, as its awards to Mr Friedman and, more recently, Joseph Stiglitz show. Mr Krugman is probably still in the running.

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Award: Iain Carson

Nov 13th 2003

The Economist's industry editor, Iain Carson, has won a special award, given by the Work Foundation, for his defence-industry survey (July 19th, 2002).

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Correction: Honeywell

Nov 13th 2003
From The Economist print edition

In our survey of corporate leadership (“Tough at the Top”, October 25th), we said that Larry Bossidy was running Honeywell. In fact, he has not been chief executive since February 2002. David Cote holds the post. Sorry.

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America's business recovery

Time to get this show back on the road

Nov 13th 2003 | DETROIT, NEW YORK AND SAN FRANCISCO
From The Economist print edition

Corbis

Businessmen in America are about to rediscover their animal spirits

Get article background

EVIDENCE of a turn in the business cycle has been met with almost bewildered disbelief by many American executives. The evidence has been rolling in: profits are rising strongly; investment by non-farm, non-financial corporations has expanded briskly for two quarters in a row; and corporate spending on computers and software is growing as rapidly as it did at the peak of the high-tech boom.

Multi-billion-dollar mergers are back. General Electric is paying £5.7 billion ($9.5 billion) for Amersham, a British life-sciences firm; and Bank of America is purchasing FleetBoston, a rival American bank, for $47 billion. Both deals are aimed at boosting future growth. In addition, an initial public offering (IPO) planned next year for Google, a search-engine firm, could turn into the biggest dotcom flotation ever. Even payrolls have begun to expand again: the economy added 126,000 jobs in October, the sharpest growth in nine months.

Yet many American businessmen, who just a few years ago were breezily predicting an almost eternal growth in profits, still seem strangely unable to rouse themselves from the torpor of recession. Last year, Jack Welch, the former boss of General Electric, warned of too much “hunkering down” in the boardroom, and there is evidence that the hunkering continues. On November 5th, John Chambers, the once-exuberant head of Cisco, a high-tech giant that makes switches to direct traffic around the internet, reported a 76% jump in his firm's profits. But, he said, this inspired in him only an “increasing but very cautious business optimism”. Half his friends at the head of other companies tell him that things are looking better, he said. The others are not so sure.

Reasons to be cheerless

What is it they are not so sure about? To some extent, they are still trying to recover from the slew of scandals in 2001 and 2002 that weakened the bond of trust between companies and investors. In its wake, prosecutors, regulators and politicians rewrote the rules of behaviour for the chief executive. But the diktats of the Sarbanes-Oxley act, the main vehicle of that process, are now firmly in place in most companies, freeing them to shift from navel-gazing to viewing the outside world.

Others can scarcely believe their financial good fortune, and wonder how long the fiscal and monetary stimulus that has so boosted the economy can last. Steven Galbraith, an analyst at Morgan Stanley, reckons that falling tax rates have been one of the least-appreciated factors behind the rise in corporate profits in recent years. But how long can the burden of corporate taxes continue to fall, ask the doubting Thomases, and how long can interest rates stay so low?

Bill Gross, an influential bond-fund manager, worries that American firms are generating an unusually large share of their profits from financial bets that depend on interest rates remaining low. Although rates have risen sharply since the middle of the year, long-term rates have softened somewhat recently, prompting fears that the business recovery (which should raise demand for capital, and hence push up interest rates) remains unusually subdued.

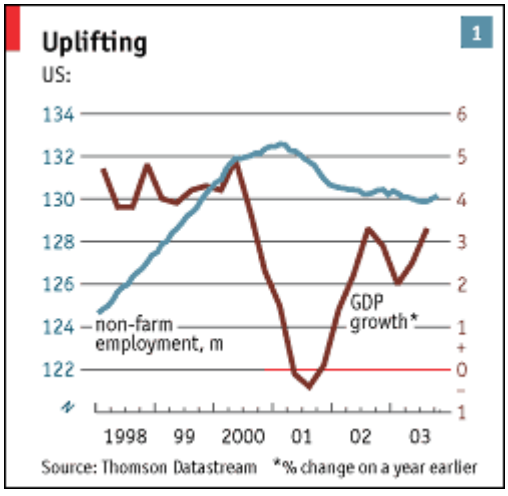
The interest-rate risk has been reduced to some extent because companies took advantage of favourable market conditions earlier this year to lock in rates for longer terms. In October, the Federal Reserve's figure for outstanding commercial and industrial loans (a proxy for short-term bank borrowing) stood at its lowest level since the summer of 1998. CreditSights, a firm of financial analysts, says it does not think “the numbers necessarily suggest a great deal of borrowing restraint” by companies. They are simply finding funds elsewhere, for longer terms and at more fixed rates.

Some of the biggest firms, however, are still clearly struggling. In late October, Standard & Poor's, a rating agency, downgraded the bonds of DaimlerChrysler. This week, it did the same to Ford Motor, the biggest American issuer of corporate debt, putting its bonds just one notch above “junk” status. Whatever stirrings of animal spirits there may be among America's bosses, they have yet to reach Detroit.

Motown blues

The continuing recession in the manufacturing heartland of the mid-west is dampening spirits more widely. Even an upturn in September left output in the seven states of the region 4% down on a year earlier. Squeezed by the advance of foreign carmakers, the traditional big three of General Motors, Ford and the Chrysler division of DaimlerChrysler have seen their market share slide from 73% in the mid-1990s to barely 60% today. The rise of the foreign brands' factories in the southern states of America is part of a drift south by car manufacturing that is to the disadvantage of Detroit. Today, more than half the car-industry jobs in the Detroit area are white-collar technical and managerial positions. The metal-bashing is heading for the sun, where the unions have less strength.

Three hours drive west of Detroit, however, the view from Boeing's new head office in Chicago is much brighter. Boeing is coping with a halving in the past two years of its commercial-jet business and the disappearance of its market for commercial satellites and the rockets that launch them. Despite these blows, the company's third-quarter profits beat expectations, and its commercial-jet business is preparing to launch its most important new product in ten years. The 7E7 is a 250-seater jet that is supposed to offer operating savings of 20% on current aircraft of a similar size.



Phil Condit, Boeing's boss, says it is the way that information technology has changed business processes that is reaping rewards for manufacturers today. His company's new plane could not have been developed so quickly without the benefit of investment in up-to-date IT, which means that parts for the plane can be produced more accurately right from the start. That eliminates the need for expensive jigs and tools on the assembly floor to hold parts in position while fitters file and trim in order to get everything to match.

No-grow area

It would be wrong to conclude from the gloom that American businesses will not soon muster again what Keynes called the “spontaneous optimism” that economies need in order to grow. On the available evidence, a remarkably normal business recovery in America is probably under way.

Take Mr Welch's jibe about the timidity of bosses. This appears to miss an important point about the last couple of years of business activity. Although company bosses have not been conquering new markets and industries in the same muscular way that Mr Welch once did, recent management efforts have nevertheless been as vital to sustaining healthy economic growth as all those macho deals of the late 1990s.

Bosses have spent the past few years correcting errors—reversing bad growth strategies, closing businesses, laying off workers and shrinking quickly back to a profitable “core” of activities. Such restructuring creates the conditions for growth to bloom again. Boeing is a case in point. Mr Welch himself began his 20-odd years at the top of GE savagely restructuring a bloated conglomerate—work that gave GE years of subsequent growth and earned Mr Welch the nickname “Neutron” Jack.

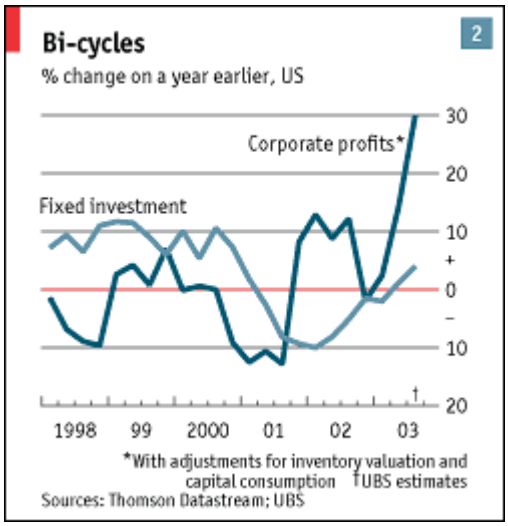
The real (and under-celebrated) achievement of American managers over the past decade may not have been the dizzying risks they took in the 1990s, but the speed and courage they have shown putting their mistakes to right. Since January 2000, America's telecoms industry has shed more than 600,000 jobs. Lucent, a manufacturer of telecoms equipment that has had to manage its way through a recession of even greater savagery than telecoms carriers such as AT&T and Sprint, is less than half the company that it used to be: it has shed three-quarters of its workers over the past few years. In the same period, more than 1,000 doomed dotcom firms have gone bust, ridding the world of business plans to sell dog food (and worse) over the internet, but also clearing the field for now-proven business models (eBay, Amazon, Expedia and the like) to grow and thrive.

The real achievement of American managers over the past decade may have been the speed and courage they have shown putting their mistakes to right

Whole industries have disappeared with shocking speed—and reappeared in different hands elsewhere. Wholesale energy-trading, for instance, was taken up by Enron as a way to transform a stodgy electric utility into a nimble risk taker. Over the past two years, however, firms such as Mirant and Dynegy have pulled capital and people out of this particular business. But energy trading is now springing up anew, and under different management, among Wall Street's investment banks.

Even those firms which went most badly wrong during the boom have been gutted, stripped bare and redecorated for sale or a relaunch. Within a month or two, WorldCom will emerge out of bankruptcy, rechristened as MCI. With its debts down from around $40 billion to just over $5 billion, and a record $750m fine paid to the Securities and Exchange Commission, the company's return will be as a new, lean competitor for the telecoms industry.

Tyco, whose former boss, Dennis Kozlowski, is currently defending himself in a Manhattan courtroom against charges of “enterprise corruption”, is now under new management, which has restored stability to its businesses and some confidence among its shareholders. Tyco's share price has more than doubled over the past 12 months. Enron, on the other hand, may disappear forever as its collection of energy assets and trading contracts are gradually cleaned up and sold to others.



One lesson that the late 1990s did teach America was the powerful effect on corporate behaviour of short-term moves in share prices. Although executives now feel under less market pressure since the discrediting of the Wall Street sell-side analysts who pushed them to have ever-shorter time-horizons, they still hear the market's call. And the current stockmarket rally has pushed the Dow Jones Industrial Average back towards 10,000, where it last stood in May 2002.

As investors' expectations about future profits growth are inflated by rising share prices, a “natural pressure builds”, says Jim Andrews of the Boston Consulting Group. In lean times, says Mr Andrews, firms tend to invest fewer of their R&D dollars in new “breakthrough” products or services. Their spending is focused instead on maintaining the competitiveness of existing products. By its nature, restructuring diminishes future opportunities for growth.

This makes the current expectations of investors in American shares look all the more unrealistic. Analysts are forecasting that corporate profits will grow by some 11% a year for the next five years. But

the long-run performance among S&P 500 firms is only 7% a year. Few of America's top managers, however, yet seem to be in a mood to take on the kind of extra risks which might meet inflated growth expectations, or beat the long-term trend, until they feel confident that restructuring has indeed dealt with all the excesses of the late 1990s. And here the picture is patchy. Industries such as telecoms and business software appear to need still further consolidation. Indicators of capacity utilisation—a measure of how fully businesses are using existing plant and people—suggest that much overcapacity persists.

On the other hand, the rapid growth of investment in computers and software this year—such business IT purchases grew at an annual rate of 18% in the third quarter, following a 19% growth rate in the second quarter—supports those economists who argue that the rapid obsolescence of IT equipment overstates overcapacity. Ageing equipment quickly becomes useless. It is no longer hanging around waiting to be used.

More than two full generations of Moore's law (which says that the number of transistors squeezed on to a computer chip doubles every 18 months) have passed since the tech bubble burst, as have more than three generations of fibre-optics communications technology. Any excess equipment dating back to the past century is likely soon to be unusable too. That should dispose of some of the recorded overcapacity.

Core blimey

Where will growth now come from? What combination of new technology, products and customers will create an enduring increase in profits? Chris Zook, a consultant with Bain & Company, has a good record in anticipating shifts in the business cycle. His last book, “Profit from the Core”, was published in 2001, just as companies were forced to set aside dreams of endless growth, and to focus on squeezing profits from their existing core businesses. His next book, to be published in January 2004, is called “Beyond the Core”. What, it asks, do you do when you have trimmed and honed your core to the limit?

Mr Zook suggests that risk-taking activities everywhere (not just in America) are more likely than not to fail. He has found, for instance, that just 30% of new product launches, less than 10% of start-ups, about 20% of joint-ventures and 30% of acquisitions create lasting shareholder value. Overall, only one in four investments in growth succeeds. Hope, it seems, triumphs over experience in the investment phase of the business cycle.

Reuters

Nike's relentless bounce

To have the best chance of success, says Mr Zook, companies should expand cautiously, into areas that are “adjacent” to their core businesses. One feature he advises executives to look for is “relentless repeatability”. “Repeatability in detailed operational processes has been shown over and over to drive productivity improvements,” he claims. Mr Zook attributes much of the difference between Nike's success in the 1990s and Reebok's relative failure over the same period to Nike's consistent application of a similar product and formula to different sports, while Reebok took a “hunt and peck” attitude to growth that included the purchase of the Boston Whaler boat company and the Ralph Lauren fashion label.

The high failure rate of America's corporate investment puts a premium on the constant recycling of labour and capital into new bets on the future, lest resources become locked up for too long in unproductive uses. Americans are now recycling their liberated resources into all sorts of different uses. Mark Hurd, the boss of NCR, for example, is betting some of his firm's money on the emergence of a new raft of venture-capital-financed software firms specialising in data analysis.

These start-ups, he says, will build on the investments that big companies have made in his own firm's data-mining technology, which allows them to capture and quiz information about their customers and suppliers. Mr Hurd foresees specialised, tailored software that might allow an airline, say, to administer its frequent-flier programme more intelligently and efficiently, or help a mobile-phone company deal more skilfully with the problem of rapid customer turnover.

Bain, meanwhile, is busily promoting “eHome”, a late-1990s-sounding convergence of the television, hi-fi and computer, all linked wirelessly to each other and, via a high-speed broadband connection, to the internet. Such connectedness, reckons Bain, opens up opportunities for firms to bundle packages of

equipment, installation and new services (like on-demand music and films) to America's ever-demanding consumers. IBM's consultants are working to introduce telematics technologies to the car industry and new “smart tags” into retailers' supply chains. IBM is also looking for growth from its market lead in providing self-service kiosks to airlines. These use touch-screen technology to reduce queues at airlines' check-in points, and IBM has rolled out a series of prestigious new customers this year, including British Airways, US Airways and United.

Not all new opportunities are high-tech and internet-based

Not all new opportunities, however, are high-tech and internet-based. Thanks to an acquisition in 2000, Cemex, a Mexican cement company, is now the biggest producer in America. It thinks wonderful opportunities lie in consolidating small producers and encouraging Americans to make more roads and houses out of (not surprisingly) cement. Barilla, an Italian pasta-maker, sees an opportunity to bring gourmet food products to America, and so renew growth in a market that has traditionally relied heavily on selling the idea of convenience. And no doubt Gillette will one day soon invent the five-bladed razor—heralding it as yet another breakthrough in male grooming. A fine example there of relentless repeatability?

The key to the recovery is the persistence of America's extraordinary dynamism. Labour and capital are quickly recycled and recombined with ever-improving materials, energy and information technologies to advance growth. Politicians, the press and America's corporate footsoldiers naturally tend to celebrate only the expansionary, risk-taking part of the business cycle. And even America's battered bosses seem to find the restructuring phase miserable work. But the real genius of American capitalism may not be its celebrated appetite for risk, but the brutal and uncompromising way in which it deals with the inevitable failures that follow. Despite the obvious signs of an economic upswing, much of American business is still concerned with cleaning up yesterday's mess. Yet with the clean-up well under way, some firms are already dusting down growth strategies once again, and at least a few businessmen are daring to show signs of spontaneous optimism.

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China's economy

Steaming

Nov 13th 2003 | HONG KONG
From The Economist print edition

Corbis

The Chinese economy is growing at its fastest for years. Is it overheating?

Get article background

IT HAS become conventional wisdom that the world economy is too reliant on America. Yet by some measures, China has accounted for an even bigger share of global growth in recent years. All the more reason, therefore, to worry about claims that China's economy is now overheating and may soon burn out.

According to a widely quoted figure (in *The Economist*, among other places), America accounted for two-thirds of the increase in global GDP between 1995 and 2002. Yet this number is a little misleading. Because it is calculated using market exchange-rates, the rise in the dollar until 2001 inflated America's share of global growth. Now that the euro is rising, the same method implies, bizarrely, that sputtering Europe has been the main source of global growth this year. It is therefore safer to use GDP figures converted at purchasing-power parity, which are not distorted by exchange-rate swings. Since these adjust for price differences between countries, they also give a relatively smaller weight to America's output.

Using this alternative method, the Bank Credit Analyst, a Canadian research firm, estimates that America accounted for only 20% of global growth in 1995-2002, while China's share was 25% (see chart 1). The rest of emerging Asia contributed another 18%. China is now a powerful engine of the world economy alongside America. Since 1995 its imports have grown twice as fast as America's. In the past 12 months they have risen by 40%, compared with America's mere 2%. If China's boom did turn to bust, the consequences could be painful.

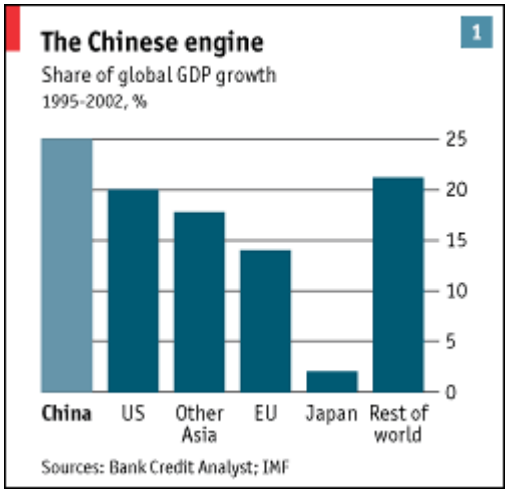
China's GDP grew by 9% in the year to the third quarter. However, many economists believe that the official figures understate the true rate, which they put at 11-12%. New figures this week showed that industrial production jumped by 17% in the year to October (chart 2). The output of cars and home appliances, such as microwaves, grew by more than 50%. Such figures give rise to fears that the economy is overheating. Is China due to repeat the experience of other East Asian economies, which overinvested grossly before being hit by financial crisis in 1997?

China is certainly hot. Foreign businessmen and bankers are flocking there to do deals. Countless seminars are being held on how to do business in China. Investment is running at a scorching 32% higher than a year ago, accounting for two-thirds of GDP growth in the third quarter. There are growing signs of overinvestment in sectors such as cars, construction and coastal property. If overcapacity pushes down profits, the investment boom will eventually turn to bust. However, there are good reasons for hoping that the bust will not happen soon.

Taking the temperature

For one thing, the government is already trying to cool down the boom. Admittedly, it is not going about this in the most direct way, by revaluing the yuan. The fixed exchange rate and strong capital inflows have caused foreign-exchange reserves and hence the money supply to swell. The broad money supply grew by 21% in the year to October. The central bank has tried to soak up the excess liquidity by selling bonds, but this “sterilisation” has its limits. More helpfully, the central bank tightened regulations on lending to property developers in June and increased banks' reserve-requirement ratio in September. The rate of credit growth is already falling. This should cause the economy to slow next year, but not to collapse.

A second reason not to panic yet is that there are few of the signs of overheating usual at a cyclical peak. China's current-account surplus suggests that domestic demand is not overstretched; inflation, although at a six-year high, is only 1.8%; and though property prices are bubbling in some cities, average house prices have risen by only 4% in the past year.



China does not look like the East Asian tigers before their crisis. Unlike China, they all had huge current-account deficits and big external debts, as well as higher inflation rates and surging property and share prices. China's is the only stockmarket among the 40 that *The Economist* tracks each week to have fallen this year.

“Overheating” usually implies excess demand which triggers higher inflation or soaring asset prices. Yet the enormous increase in industrial capacity suggests that deflation may still be a bigger risk. Some industries, such as electricity and steel, are short of capacity. However, the economy as a whole is not overheating as it did in the early 1990s, when there were widespread shortages and higher inflation.

Andy Xie, an economist at Morgan Stanley, agrees that the government need not worry about inflation. Instead the problem is that China's underdeveloped financial system is bad at allocating funds efficiently, and gets worse as growth speeds up. The government therefore needs to slow the economy to avoid another wave of bad loans. Mr Xie predicts that the current tightening of credit could cause investment growth to fall by half in 2004. But he expects overall GDP growth to hold up, at 7-8%.

A third reason for hoping that China's boom is not about to go bust is that official figures probably overstate investment. Jim Walker, an economist at CLSA, a Hong Kong broker, points out that China's statistics are notoriously dodgy, and that the investment data are among the least reliable. According to official figures, investment was 40% of GDP in 2002. Adding in this year's investment growth may have lifted it to 47% of GDP. That would be even higher than in the rest of Asia on the eve of its late-1990s crisis. No wonder many economists say this is unsustainable.

However, Mr Walker reckons that China's investment is almost certainly lower than claimed, and that the investment boom therefore has further to run. One way to demonstrate this is to remember that the gap between domestic saving and investment must be equal to the current-account balance, which is probably measured more accurately. Mr Walker estimates domestic saving from money-supply and capital-account data (which, again, should be more reliable than national-account numbers). This suggests that saving was 30% of GDP in 2002.

Taking the difference between that and the official investment figure would imply a current-account deficit of 10% of GDP. In reality, China has a current-account surplus, which means that savings must exceed investment, not the other way around.

The obvious explanation is that investment is really much lower: last year's current-account surplus of 2.8% of GDP and a saving rate of 30% would imply an investment rate of 27% or so. If that is roughly right, China's economy can keep steaming for a while yet. One day, the investment boom may well turn to bust, but not yet.

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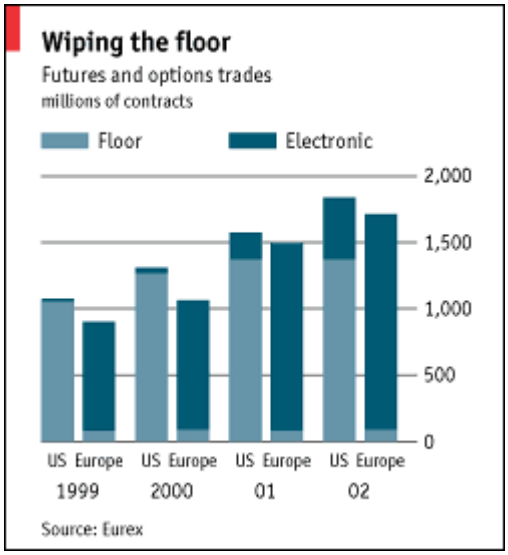
American futures exchanges

The front line of futures

Nov 13th 2003 | CHICAGO
From The Economist print edition

Eurex attacks, Chicago's exchanges defend themselves



THE battle over America's futures markets is raging. In the thick of it are Eurex, a German-Swiss exchange that plans to set up a new, all-electronic operation in the United States, and America's two largest futures exchanges, the Chicago Board of Trade (CBOT) and the Chicago Mercantile Exchange (CME), which are fighting fiercely to protect their turf. The prize is rich: the global volume of futures trades has almost doubled in the past five years.

In the fray, political and legal weapons are being deployed as ruthlessly as business strategy. Eurex's application to set up shop in Chicago is now before the Commodity Futures Trading Commission (CFTC), the industry regulator. The planned launch date is February 1st, when Eurex wants to start offering trading in American Treasury futures, head-to-head with the CBOT. Because both the CBOT and the CME have raised several objections, a decision might not be made by then. This would buy the CBOT more time to secure its hold on the Treasury market. Eurex, which has hit back with an antitrust lawsuit, has friends too. Among others, Alan Greenspan, chairman of the Federal Reserve, has expressed support for competition from foreign-owned exchanges.

Whatever happens in Washington, the competitive landscape in Chicago has already changed dramatically since January, when Eurex first tipped its hand. It promises low trading fees and broader access to the market, partly by eschewing the Chicago incumbents' membership model, which requires traders to buy “seats” on an exchange. The CBOT and CME have responded by slashing fees and by setting aside past differences to agree on a common system for clearing trades, which goes live on November 23rd. The CME is taking the battle to Eurex's home territory: on November 10th it slashed fees for non-member European customers using its Globex electronic-trading system.

The slow pace at which the CBOT and the CME have gone electronic irks big broking firms that must support trading both in the Chicago exchanges' traditional open-outcry pits, to which some influential traders cling, and on screen. The threat from Eurex seems to have spurred the Americans on. Nonetheless, says David Norman, an expert on market technology at the Illinois Institute of Technology, “Eurex isn't the catalyst here, it's being reactionary. It is the last straw in a long line of events persuading the exchanges to adapt.”

New technologies, many developed in Chicago, have done much to reshape the industry as complex algorithms have allowed electronic traders to conduct ever more complex transactions. “Chicago is a hotbed of innovation right now,” says Mr Norman. “What comes out of the city in the next two to three years is going to be seen globally as cutting-edge.”

These new technologies not only siphon business away from the pits (see chart) but also attract new players. Eurex hopes to lure small day-traders and independent operators working in “arcades” to its exchange. This is creating competition among suppliers of software to connect such traders. Internet trading systems are now nearly as good as direct links to exchanges, if a bit slower, making it easier to trade from home or in the arcades that are springing up around Chicago.

Two events later this month make plain the changes in Chicago. One is the first step in the CBOT's switch of trading to an electronic platform

AP

run by Liffe Connect, which is owned by Eurex's European rival, Euronext.liffe. CBOT's decision to drop Eurex as a technology partner was the final prompt for Eurex's plans for its own American exchange. The other is the initiation of the CME's and the CBOT's common clearing link, which the exchanges claim will save traders as much as $1.6 billion a year. The two exchanges have long been fierce competitors. But the CME's chairman, Terry Duffy, and the CBOT's, Charles Carey, traded hog contracts together two decades ago on the CME. That and the threat of a foreign interloper may have blunted the old rivalry.

Signs of change in Chicago

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American stock exchanges

Printing money

Nov 13th 2003 | NEW YORK
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A new name for a peculiar American stock exchange

ON NOVEMBER 7th the Cincinnati Stock Exchange renamed itself the National Stock Exchange. Not before time: it left Cincinnati long ago. Few people noticed, even though in the past two years it has been America's fastest-growing stock exchange, capturing one-fifth of trades in shares listed on NASDAQ, one-tenth on the American Stock Exchange and a tiny slice from the New York Stock Exchange (NYSE).

It would be hard to imagine a less likely competitor. Most of America's regional exchanges died out after the second world war as steadily declining communication costs allowed trading to consolidate in large centres, primarily New York. In the late 1960s, the Cincinnati exchange was trading fewer than 2,000 shares a day, mostly of the local telephone and gas utilities. Although its days looked numbered, it was saved by becoming a sort of laboratory for Weeden & Co, an innovative securities firm. By the mid-1970s, it had introduced one of the first electronic trading systems. By 1980, Cincinnati had done away with its trading floor altogether.

The exchange survived. The Chicago Board Options Exchange (CBOE), the smallest of Chicago's three derivatives exchanges, bought 68% of it. In the early 1990s its bosses moved from Cincinnati to a building next door to the CBOE in downtown Chicago. The CBOE runs the Cincinnati exchange's computers as well as its own. Until a couple of years ago the tie-up was not a success, and rumours persist that the CBOE would like to bail out.

The Cincinnati exchange's prospects began to brighten two years ago. For regulatory reasons Island, an electronic network used mainly by day traders, needed an exchange authorised by the Securities and Exchange Commission to report transactions on its system, a process known as “printing the trade”. The Cincinnati exchange made it a good offer. “We pay people to do business with us,” says David Colker, the exchange's chief executive.

How can the exchange afford to pay? The answer lies in a little-known wrinkle in the way exchanges do business. The data produced by trading has a market value. It is sold for up to 20 cents per reported transaction on the NYSE and NASDAQ. If a trade takes place on the Cincinnati exchange, it sells the data and rebates 70% of the proceeds to the trader. “It's a legal kickback scheme,” says Benn Steil, of the Council on Foreign Relations.

An abbreviated income statement for the exchange appears in the CBOE's annual report. It shows that in the fiscal year ending in June 2003, “other” revenues grew to $15m, up from $5m the year before. Presumably this reflects revenue from data contributed by Island's trades. “Other expenses” grew almost as fast, presumably reflecting the rebates. James Angel, a professor at Georgetown University, says that by living off this tape revenue the Cincinnati exchange has shown how much wealth is buried inside the trading system.

Mr Colker can speak at length about the virtues of the exchange. Mr Angel is more sceptical, saying that it is a good bet that trading on the exchange does little to provide insights into the worth of companies, often thought of as one of the major virtues produced by any exchange.

An advantage for some who trade on the Cincinnati exchange is that they probably do not get pestered much by regulators. The exchange's regulatory budget is less than 1% of that of either the NYSE or NASDAQ's parent, the National Association of Securities Dealers—both of which admittedly have much larger supervisory roles. Unlike more established exchanges, the Cincinnati exchange does not disclose miscreants' names or traders' regulatory violations. “We do not share this information with the public,”

says a spokesman. With America's regulators in a tizzy, this is a selling point, though a dubious one for something with the grand new name of the National Stock Exchange.

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Accountancy and law

Back to basics

Nov 13th 2003
From The Economist print edition

The aspirations of accountancy firms in the law are faltering

KPMG was the last of the big accountancy firms to enter the legal arena, and is the first to throw in the towel. On November 7th the firm announced it would cut its ties with KLegal International, its network of 3,000 lawyers in some 60 countries. The firm ascribed the end of its four-year effort to build a legal branch to “market conditions” and America's Sarbanes-Oxley act, which restricts the provision of non-audit services to audit clients.

The other three of the world's “Big Four” accounting firms deny that they are about to follow KPMG out of the legal trade. Ernst & Young says it remains committed to its legal network. PricewaterhouseCoopers (PwC) says it has no plans to change its arrangement with Landwell, the law firm with which it is associated. Deloitte & Touche also intends to keep its ties with law firms.

Fine: but even if accountants stick to their plans, their ambitions now are a shadow of what they were five years ago. Then the Big Five (Arthur Andersen was the fifth) were in rude health and looking to expand. Attracted by the high fees lawyers earn and the growth in cross-border business, PwC wanted to be one of the top six law firms in every country in which it operated, including America. Ernst & Young's stated aim was to have a global law firm with 4,000 staff by 2003 or 2004.

Then came the accounting frauds at Enron, WorldCom and elsewhere, and the implosion of Andersen. The accounting industry was in turmoil, its executives in disgrace. In July 2002 America's Congress passed the Sarbanes-Oxley act to disentangle conflicts of interest at (among other places) accounting firms. The act required the Securities and Exchange Commission (SEC), America's regulator, to write rules that deem an accounting firm to lack independence if it provides legal services to auditing clients.

Sarbanes-Oxley put an end to selling legal expertise alongside accountants' other services to listed companies. Such cross-selling was tricky enough anyway, because many countries, notably America and Britain, require a strict separation of the legal and other professions. Accountancy firms circumnavigated this obstacle by forging alliances with law firms rather than merging with them. Still, Sarbanes-Oxley has stopped even that, and it is being copied in other countries. On August 1st French legislators approved severe restrictions on the combination of accountancy and legal services. Germany is pondering a similar law.

Earlier this year, Ernst & Young rethought the strategy of Ernst & Young's Law Alliance, a loose association of law firms in more than 60 countries. In June the alliance was tightened and rebranded as EY Law. Law firms in some 30 countries with about 2,000 lawyers joined EY Law, which caters for a much smaller group of clients than the old arrangement did. EY Law is not providing legal services to companies registered by the SEC or to firms audited by Ernst & Young.

Meanwhile, lawyers tied to PwC are leaving in droves. Last week Landwell's Luxembourg firm became the latest member of PwC's legal network to separate from the accounting parent. In October, several dozen Landwell lawyers defected from the firm's French practice. At the same time Landwell's Dutch subsidiary cut its ties with PwC. The Belgian branch dropped out in June. Today PwC's network is left with just four Landwell law firms, in Britain, France, Spain and Bulgaria. Lawyers linked to Deloitte & Touche are jumping ship too. Last month Deloitte & Touche Juridique et Fiscal in Paris severed its link with the accounting firm.

When law firms hardly benefit from accountants' huge client base and accountancy firms are allowed to offer legal services only to a few clients, there is little point in accountants having a legal arm. Moreover, law firms have themselves become more global in recent years and many do not need the accountancy

giants' international reach. “Accountancy firms' drive in the legal arena is dead,” says John Malpas of *Legal Week*, a trade publication. At present law firms that used to be part of KLegal are discussing whether to keep their alliance, in order to try to serve KPMG clients independently of the accountant. The question is whether KPMG clients want them.

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Financial reform in Japan

Friendless

Nov 13th 2003 | TOKYO
From The Economist print edition

Japanese banks have lost their chief political protector

AP

Aizawa, another asset to write off

WHO has been the most important financial policymaker in Japan in the past few years? Heizo Takenaka, reappointed two months ago as financial-affairs minister? His boss, Junichiro Koizumi, the prime minister? Arguably, the answer is neither of these, but Hideyuki Aizawa, head of the ruling Liberal Democratic Party's (LDP) powerful committees on anti-deflation and tax and the chief political protector of Japan's sickly banks. Now Mr Aizawa's reign is over. He lost his seat in the general election on November 9th.

In 2000, Mr Aizawa, now 84, was briefly Japan's top financial regulator. He has been particularly influential since that year, shaping policy mainly behind the scenes as leader of the LDP's finance “tribe”, which lobbies on behalf of banks. Last year, having proposed some mild bank reforms, Mr Takenaka had to beat a swift retreat in the face of Mr Aizawa's opposition. Mr Aizawa also helped persuade Mr Takenaka to push back a weakening of deposit insurance for two years (until March 2005), much to the relief of weak banks who feared the change might prompt a rapid withdrawal of deposits. He also opposed a proposal to restrict the amount of “deferred tax assets” which banks are permitted to count as capital. The idea was shelved earlier this year.

Banks have lost powerful allies in election upsets before. Mr Aizawa's fall, however, has left a vacuum. Kazuyoshi Kaneko, a staunch friend of the banks, might have taken over Mr Aizawa's role if he had not recently been appointed minister in charge of administrative and regulatory reform. He will be too busy with his new duties, which include heading a government institution that rescues some of the banks' worst borrowers, to argue the banks' case within the LDP. Yet finding a new political protector is critical, especially for regional banks and credit unions, which face increased regulatory scrutiny. Although rising stockmarkets have given big banks some respite from their problems, they remain riddled with bad loans and will also be looking for new political patrons.

Mr Aizawa was not the only financial specialist to lose his seat or to retire at the election. The LDP is thus short of expertise. Uncomfortably for the banks, perhaps the most prominent of the remaining experts, Yasuhisa Shiozaki, is a radical reformer whose views sit uneasily even with the less conservative parts of the party. In any case, Mr Aizawa's departure should be a marvellous opportunity for Mr Koizumi and Mr Takenaka to press on with reform—if that is really what they want to do. Then again, they may have merely lost their best excuse for not doing so.

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Insurance and gender

The price of equality

Nov 13th 2003
From The Economist print edition

Unisex insurance premiums may cost consumers more

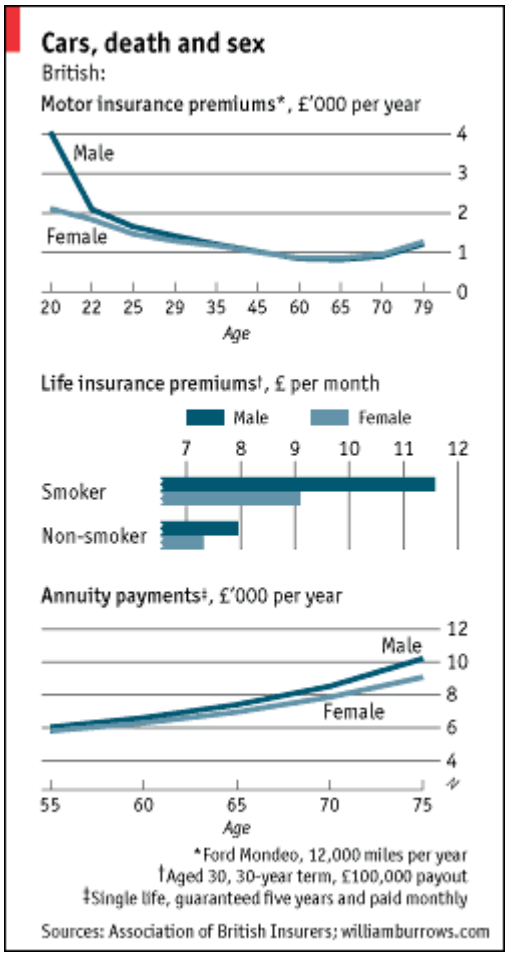
ANNA DIAMANTOPOULOU, the European Commissioner for employment and social affairs, and European insurers are at loggerheads. Ms Diamantopoulou says her proposed directive on equal treatment of men and women outside the workplace, which would ban insurers from charging different prices to men and women, is fair. Insurers say that average premiums will rise if the directive, which was approved by the commission on November 5th, comes into effect.

Almost all insurers in America and Europe charge men and women different premiums for life and motor insurance. Men are likelier to die earlier and have car accidents (especially when young) and therefore pay more. By dint of their longer life expectancy, women can buy smaller annuities with a given sum than men of the same age (see chart). Some insurers charge for health and accident cover according to sex. A few American states prohibit pricing by gender. In Europe, only France bans this practice.

Ms Diamantopoulou argues that gender is not the main reason why women live longer or men are likelier to crash their cars. Citing a number of studies, she says that marital status, employment, where people live, whether they smoke and what they eat are far more important determinants of life expectancy. “Insurers appear to be using a person's sex as a proxy for these other lifestyle factors because it is easy,” says Ms Diamantopoulou.

Insurers retort that policyholders are likely to prefer the current regime, which is based on actuarial evidence, rather than on less precise lifestyle factors. They already take into account whatever they can, such as smoking or drinking habits, when selling life cover. The more insurers can discriminate, the more precise they can be about the probability of having to pay out. If they are not to discriminate on the basis of gender, the risk they are taking is less certain. To guard against losses, they are thus likely to charge more, on average, to insure women and men together than they would if they could continue to charge separately.

Before it becomes law, Ms Diamantopoulou's draft directive must be approved, first by the European Parliament and then, in a unanimous vote, by the Council of Ministers. Meanwhile, insurers and other providers of goods and services likely to be affected by the directive are preparing to lobby loudly in Brussels. Policymakers might still be persuaded. One profession lobbied so successfully before the directive was published that it managed to be exempted from Ms Diamantopoulou's drive for gender-neutral prices. Europe's hairdressers may continue to snip with discrimination.



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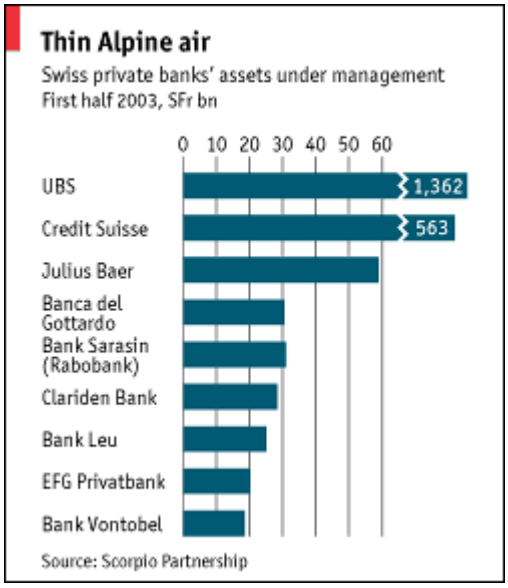
Swiss private banks

Abroad thoughts from home

Nov 13th 2003
From The Economist print edition

Switzerland's private banks face a bleak future—if they stick to Switzerland

A HEARTENING sign for Switzerland's beleaguered private banks? On November 11th UBS, Switzerland's biggest bank and the world's largest private bank, announced record inflows from the well-heeled, with net new money up 56% so far this year compared with 2002. Sadly, UBS's sparkling results say more about the big Swiss bank than they do about the health of private banking in Switzerland which, if anything, continues to worsen.



Historically, Swiss banking's success was based on a few simple principles: no turmoil, no talk and no taxes. Despite a sudden rightward lurch in a recent election, Switzerland remains stable, and European countries which surround it now, thankfully, pursue their interests at the conference table rather than the front line. But no talk and no taxes are no longer guaranteed. Banking secrecy is crumbling because of foreign pressure not to provide a home for money from dictators, terrorists and organised crime. And for Europeans, at least, neutral Switzerland is no longer a safe tax haven.

Money-laundering laws have been passed already, but foreign pressure for more transparency ratchets ever higher. In a concession to the European Union, which is cracking down on tax evasion, Switzerland is likely to impose a withholding tax (a tax imposed at source on interest) in exchange for keeping the identities of EU citizens confidential. The neighbours also have a growing penchant for tax amnesties, under which tax-dodging citizens who bring home money salted away abroad (often in Switzerland) will not be prosecuted. Recent Italian amnesties took in some €50 billion ($58 billion); Belgium and Germany hope to launch their own.

UBS's results illuminate how unattractive Switzerland is becoming. Of the SFr9.4 billion ($6.9 billion) that flowed into the bank last quarter, almost a third was from Europe, but only SFr400m came from clients in Switzerland. In its move to countries with more potential for growth, the bank bought Merrill Lynch's private-banking business in Germany in October and one in France from Lloyds TSB in May.

Tellingly, most of these investments are in businesses that look after domestic money rather than in those that look after slightly dodgy foreign cash, a traditional Swiss speciality. At the moment, some 70% of the European money managed by private banks is onshore money. But Christian de Juniac of BCG, a consultancy, expects that to rise markedly, in part because of the inexorable rise of transparency.

None of this is good news for small and middling Swiss private banks. Private money managed in Switzerland fell by 13% to SFr3 trillion in 2002, according to the Swiss National Bank, and profits have been hit harder. Profits at Julius Baer, one prominent private bank, dropped by 19%.

The likes of Credit Suisse, Switzerland's second-biggest bank, and Citigroup, the world's biggest, have pockets deep enough to finance international expansion. Expansion is especially difficult for the handful of private banks, such as Pictet, which are partnerships and which therefore lack the capital to fund rapid growth. Competing is harder still because today's rich are more demanding than the monied of old, who were more interested in preserving wealth than in boosting it. So banks must provide a broader range of more sophisticated investments: UBS offers wealthy clients hedge funds and advice on the art market.

Then there are the costs of complying with new regulations—from increased disclosure to new rules for international bank capital (Basel 2)—which bigger banks can spread across a wider base. Consolidation is one answer. Ray Soudah of Millenium Associates, an adviser to private banks, expects the number of attempted mergers or acquisitions to rise from below ten this year to perhaps 50 in 2004.

But the economics of mergers are not as compelling as they are elsewhere in fund management because rich investors expect a personal service, and so staff account for half of total costs at most private banks, according to BCG. Many smaller banks are instead opting for an “open architecture” business model, mixing their products with those of others.

Increasingly, even smaller banks are venturing abroad. Julius Baer, one of the more active, has launched a joint venture in Italy and wants an office in Dubai. It closed its Berne office in October.

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Economics focus

God, man and growth

Nov 13th 2003
From The Economist print edition

Two economists go where angels fear to tread

IF YOU want to avoid an argument over religion at your next dinner party, you might suppose it safe to invite an economist or two. They, of all people, could be expected to stick to Mammon. Or maybe not, if a new paper* by Robert Barro, one of America's best-known economists, and Rachel McCleary, a colleague at Harvard University, is any guide. It explores the influence of religious belief and observance on economic growth.

To be sure, this is not the first time that economists have held forth on subjects that many people consider private. Gary Becker, a Nobel laureate at the University of Chicago, is well known for applying economic theory to questions such as whether marriage is economically efficient, whether drug addiction is rational and how couples decide how many children to have. Mostly, though, economists have so far left religion alone. However, other students of society have not been shy of offering ideas about religion and wealth. A century ago, Max Weber, a founder of sociology, observed that the Protestant work ethic was what had made northern Europe and America rich. Recently, Niall Ferguson, a British historian at New York University, argued that today's economic stagnation in Germany and other European countries owes much to the decline of religious belief and church attendance during the past four decades. The Protestant work ethic, he thinks, is dead.

If there is a link between religion and economic performance, then economists ought to have something to say about it. To test the connection, however, economists need figures, ideally covering many countries and many years. This is where Mr Barro and Ms McCleary come in. They have collected data from surveys of religious belief for 59 countries in the 1980s and 1990s—whether people say they believe in God, heaven and hell, and whether they attend services at least once a month—and have tried to tease out whether these have any direct effect on GDP growth.

This is not easy, because in theory the causal arrow could run either from religion to economic growth or in the other direction. On the one hand, adherence to religion might foster behaviour that helps a nation to become rich. The Protestant ethic emphasised thrift and willingness to work hard. Honesty might generate trust. Openness to strangers could lead to openness to trade and immigration. On the other hand, economic growth might bring about changes in a country's religiosity. As European countries have become richer during this century, fewer people have gone to church. In America, however, the downward trend has stopped, or even gone into reverse, in recent decades and Americans are far more religious than Europeans. It is also thought that church attendance declines as people become better educated and as they move from the country to the city. Both these shifts tend to accompany economic growth.

In order to sort this out, the authors needed to find measures of religion which are not themselves affected by GDP growth. To do this, they draw on a fundamental tenet of orthodox economic faith: that more competition is better. In some countries, religion is (or was) banned altogether or discouraged. In others, a single strand is sponsored by the state. In others, there is a free-for-all.

Earlier studies, say the authors, suggest that religion is more likely to flourish where there is less state control and a greater diversity of belief. So they use this to test the impact of religion on growth. Up to a point, their findings corroborate some common perceptions. More prosperous countries seem to have lower rates of church attendance, although America—the best instance of a country of competing sects rather than a state religion—is a conspicuous exception. More urbanised countries tend to be less religious. However, contrary to what many people think, religion seems to have a stronger hold in countries with better educated populations.

The general theory of fire and brimstone

The most striking conclusion, though, is that belief in the afterlife, heaven and hell are good for economic growth. Of these, fear of hell is by far the most powerful, but all three indicators have a bigger impact on economic performance than merely turning up for church. The authors surmise, therefore, that religion works via belief, not practice. A parish priest might tell you that simply going through the motions will bring you little benefit in the next world. If Mr Barro and Ms McCleary are right, it does you little good in this one either.

Indeed, Mr Barro and Ms McCleary go further. They find that church-going, after a certain point, is (in an economic sense, anyway) a waste of time. They argue that higher church attendance uses up time and resources, and eventually runs into diminishing returns. The “religion sector”, as they call it, can consume more than it yields.

All this is intriguing, but does religion make much difference? Japan, where there are many sects but little fear of hell, has grown far faster since the second world war than the Catholic Philippines. Officially atheist China is growing at a cracking pace. Presumably, what your religion is matters as much as whether you are religious: has anyone theorised about a Catholic work ethic? And if religion does have an effect, is a 20-year period long enough to find it?

Equally, religious people would say that prosperity is not the purpose of faith. Few these days would even see it as a reward for their belief and behaviour, but as at most a by-product, and then not necessarily a welcome one. Recall Jesus's words about the rich man, a camel and the eye of a needle. So is Mr Barro's and Ms McCleary's rough, preliminary research good news for the faithful? Or is it just a little disconcerting?

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* “Religion and Economic Growth”, NBER working paper no. 9682. Available at http://www.nber.org/papers/w9682

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Memory and emotion

Thanks for no memory

Nov 13th 2003
From The Economist print edition

Some evidence about how and why memories are suppressed

ACCORDING to Freud's theory of repression, the mind hides memories of traumatic events in places where they cannot easily be retrieved, in order to prevent overwhelming anxiety. It is these “repressed memories” that the memory-recovering techniques beloved of some psychiatrists aim to unearth.

The existence of repressed memories is taken as a truism by psychiatry. Unfortunately, it has never been verified by rigorous scientific experiment. And that is not a matter of mere academic interest, since memories apparently recovered by psychiatric techniques such as hypnosis—particularly memories of childhood abuse—have sometimes been enough to put people in prison, even when there has not been any corroborating evidence. Moreover, even in cases where an individual has undoubtedly witnessed something traumatic, the reliability of his memories can be critical to convicting the true perpetrator. Witnesses frequently disagree, and this may reflect the way memory forms. Some actual data on the relationship between unpleasant experiences and memory would therefore be welcome.

In this week's *Proceedings of the National Academy of Sciences* Bryan Strange, of University College, London, and his colleagues provide some. Rather than abuse their experimental subjects, though, they merely showed them streams of words on a computer screen.

Totalless recall

Some of these words (murder, massacre and so on) had bad connotations. Others (meeting, gathering and conference, for example) were emotionally neutral. The subjects of the experiment, who did not know in advance what was required of them, were asked to look at the stream, which was presented one word at a time. Then, when they had been shown it, they were asked to recall the words in it. In the past, this technique has showed that emotionally charged words are more likely to be recalled than neutral ones. What Dr Strange wanted to look at was how well people remember neutral words adjacent to the emotionally charged ones in the stream. He discovered that words immediately preceding emotionally charged ones were less likely to be remembered than normal.

Intrigued, he pushed a little further. Previous work had established that emotion-associated enhancement of memory is caused, at least in part, by the action of stress hormones, in particular

norepinephrine, on a part of the brain called the amygdala. He wondered if a similar mechanism was at work in the emotion-associated memory loss the team discovered.

The action of norepinephrine on the amygdala can be blocked by a drug called propranolol. When the researchers repeated their experiments on volunteers who had been dosed with this drug, they found, as expected, that those volunteers did not remember emotional words any better than neutral ones. In addition, however, they found that memory for neutral words which preceded emotional ones improved.

The team was also able to draw on evidence from a patient who suffers from Urbach-Wiethe disease, a rare genetic disorder that can cause damage to the amygdala. They used brain-imaging techniques to confirm that her amygdalas (people actually have two, one in each hemisphere of the brain) were, indeed, damaged. They also measured her cognitive functions—intelligence, attention and both short-term and long-term memory—and found that these were normal. But her memory was not affected by emotion; she remembered emotionally charged and neutral words equally well, regardless of the order they were presented in.

The memory gap

The kind of memory Dr Strange studied is called explicit memory. It concerns facts and experiences—knowledge that can be recalled by conscious effort and can be reported verbally. Researchers believe that explicit memory is formed in several steps. The first is translating newly learned information into so-called neural correlates. This does not involve permanent changes to the brain's structure. In the second stage, consolidation, structural changes such as the formation and destruction of connections between nerve cells take place. This process involves the expression of genes and the synthesis of new proteins, and Dr Strange suspects that emotion interferes with these biochemical events. As a result, no memory is formed.

Another line of evidence that supports this interpretation is work on post-traumatic stress disorder (PTSD) carried out by Roger Pitman, of Harvard University. Dr Pitman recently conducted a trial to see if propranolol could prevent the development of this disorder, which afflicts those who have been exposed to horrific events, such as battles or plane crashes, with emotionally disturbing flash-back memories. He reasoned that excessive amounts of stress hormones released at the time of a traumatic event might be responsible for overly strong memory formation. Because memory takes time to form, he conjectured that drugs which block the action of these hormones soon after the trauma might decrease the intensity of the memory. This turned out to be true: a course of propranolol started shortly after an acute traumatic event was able to reduce the symptoms of PTSD one month later.

On the face of it, there is something slightly contradictory about these results. It is odd that the amnesia observed by Dr Strange is for events just before an emotionally charged incident, when what is actually desirable is to wipe away any recollection of the incident itself. But a simple laboratory experiment using what are, after all, ultimately harmless words, is not the same as a case of child abuse or the horrors of war. And it seems clear that the amnesia, as well as the memory formation, is in some way a result of the stress hormones.

What is undoubtedly true is that memory, like everything else in biology, is an evolved, functional response. If individuals tend to be better off by not remembering certain things, natural selection will tend to construct their brains that way. Indeed, the existence of post-traumatic stress disorder suggests that individuals are better off without those memories. And in fact, most people do come out of trauma with their psyches intact, so it is possible that what has happened to PTSD sufferers is that the memory-prevention mechanism has gone wrong.

Freud might thus have been right about the reason for what he thought he had observed about trauma and memory. But it looks as though he was wrong about the mechanism. The evidence, though limited at the moment, suggests that memories are not repressed. Rather, they are never formed in the first place. Obviously, no psychiatric technique can recover something that was not there to start with. That is something of which the courts should be acutely aware when they assess the credibility of witnesses. It is also something psychiatrists may care to ponder when they are trying to dredge up “forgotten” childhood memories.

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Treating arthritis

Leeching away pain

Nov 13th 2003
From The Economist print edition

An old remedy may have a new application

AS RECENTLY as a century ago, many doctors carried a few leeches around in their bags. Leeches, though often abused by quacks, had real value for controlling blood clots because their saliva contains an anti-clotting agent.

Today, that job is normally done with anti-coagulent drugs—although leeches are occasionally used to deal with post-operative clotting. Leech saliva, however, contains another agent that enables the animals to extract the maximum amount of blood from their hosts, with the minimum amount of fuss. This is an anaesthetic. And a group of scientists led by Andreas Michalsen, of the University of Duisburg-Essen, in Germany, has just put this fact to the test, to see whether it might be useful for relieving the pain of arthritic joints. The upshot, reported in *Annals of Internal Medicine*, is that it is.

Dr Michalsen picked 51 people suffering from osteo-arthritis of the knee. (Osteo-arthritis is the sort caused by wear and tear, as opposed to rheumatoid arthritis, which is caused by the immune system attacking the body's own tissue.) About half of these people were treated with twice-daily doses of a painkilling drug called diclofenac, applied to the affected knee. The others were given a one-shot treatment with leeches. This involved allowing four to six leeches to attach themselves to the knee, and then feed until they let go of their own accord, which they tended to do after about an hour. Everyone was asssessed in detail over the course of a month from the start of treatment, and more generally over the course of three.

The result was that leech therapy beat diclofenac for pain relief, particularly in the first week after application. It also seemed to bring longer-term benefits in the form of reduced stiffness and better joint function, probably because besides dulling pain, leech saliva also acts as an anti-inflammatory agent. Whether such benefits outweigh the disadvantages of having half a dozen leeches feasting from your knee for an hour is a matter of personal taste.

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Gamma-ray bursts

Bursting with controversy

Nov 13th 2003
From The Economist print edition

Arguments continue about the biggest explosions in the universe

GAMMA-RAY bursts (GRBs) are one of the most mysterious and controversial things astronomers can see. Mysterious, because until a few months ago, there was no consensus about what caused them. Controversial, because even though there is now agreement about the underlying cause—supernovas—there is an argument about how such stellar explosions actually generate gamma rays.

These rays are an energetic form of electromagnetic radiation. (More familiar forms of this radiation include radio, light and X-rays.) About once a day a spot in the sky lights up with a burst of them so intense that it is billions of times more powerful than anything else in the universe.

There are two theories about how the gamma rays in these bursts are generated. One is that they are a form of synchrotron radiation—the radiation produced when electrically charged particles are forced to travel in a curve by a magnetic field. The other is that they are formed by an interaction between low-energy electromagnetic radiation, such as light, and high-energy charged particles produced in the explosion. This is a process known as inverse Compton scattering.

In the past year, two satellite observations that bear on this and other questions about GRBs have been made. One, in late March, was carried out by HETE-2, a multinational satellite explicitly designed to search for GRBs. Because this burst was one of the closest to Earth that has ever been observed, astronomers were able to see, in the position that HETE-2 predicted, the remains of a supernova. It was this that confirmed supernovas as the cause of GRBs, rather than colliding neutron stars or even more exotic ideas such as rents in the fabric of space.

The other observation, however, was in some ways more remarkable. It was made in December 2002 by RHESSI, an American satellite actually designed to observe the sun. Serendipitously, a burst occurred in the same part of the sky as the sun, and RHESSI saw it. But it is this accidental observation, not one made deliberately, that bears on the question of what causes the gamma rays. That is because it allowed researchers to try to measure their polarisation.

Trying, though, is not the same as succeeding. Wayne Coburn and Steven Boggs of the University of California, Berkeley, used the RHESSI data to assert, in a paper published in May in *Nature*, that around 80% of the gamma rays in this particular burst were “linearly polarised”. According to a paper just published in *Astrophysical Journal* by Maxim Lyutikov of McGill University in Montreal, and his colleagues, that is because the magnetic fields of the supernova were carrying the bulk of the energy of the burst. This suggests the gamma rays are generated by synchrotron radiation.

But a few weeks ago Robert Rutledge and Derek Fox of the California Institute of Technology (CalTech), in Pasadena, came up with the opposite conclusion from the same set of data. They have written a paper in which they claim that Dr Coburn and Dr Boggs have made a mistake in their analysis. According to Dr Rutledge and Dr Fox, the data actually show negligible polarisation. Dr Coburn and Dr Boggs have since written another paper defending their analysis, and say a more thorough defence is forthcoming.

A yardstick for the future?

The result from HETE-2 is remarkable enough, however, because it pinned the burst down so quickly and precisely. Before that, GRBs had been hard to locate. This was because they are so bright that they tended to overwhelm the available detectors. But HETE-2 is a recently launched satellite, with a better detector, and because the burst it saw was relatively close by, it was fairly easy to locate the remnants,

and thus examine them.

Although GRBs themselves last at most a few hundred seconds (the shortest take mere milliseconds), they leave an afterglow. By understanding this, physicists hope they can understand the bursts themselves. Three papers in this week's *Nature* examine the afterglow of the March burst. Two go into details, such as the polarisation of light from the glow and the nature of a bump that appeared in that glow a few days after the explosion. But the third may ignite yet more discord. Edo Berger, of CalTech, and his colleagues dispute the claim, made by several researchers in the past few years, that all GRBs release the same amount of energy.

If that claim were true, it would mean that GRBs could be used as cosmic “yardsticks”, since their distance could be worked out from their apparent brightness. Existing yardsticks, which include certain supernovas, are important because they provide ways of calculating how fast the universe is expanding. Because GRBs are so much brighter than anything else, they would be particularly useful in this context. However, Mr Berger argues that the size of the March GRB, whose supernova-of-origin is understood, rules out the idea of standard-energy GRBs. Different supernovas, he concludes, release different proportions of their energy as gamma rays, and those differences are not predictable. A shame. But though they may turn out to be less useful than hoped for in analysing the rest of the universe, GRBs still seem to be generating plenty of interest—and controversy—in their own right.

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More on gamma-ray bursts

Perishing publishing

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"Pre-printing" scientific papers electronically is a good idea. But it has its perils

GAMMA-RAY bursts (see article) have created more than just scientific debate. Sir Martin Rees, England's Astronomer Royal (these days an honorific title; Sir Martin is also a professor at Cambridge University), has become embroiled in a controversy that raises questions about the way that scientific papers are published.

In the olden days, a group of researchers would bang out their paper on paper. They would submit it to a journal. They would wait several months for it to be accepted (or not) and then several more for it to be published. Though long winded, this allowed time for reflection by both authors and the independent referees who the provide "peer review". This helped to keep the scientific process accurate.

The world wide web has changed that. Now, physics papers often get "pre-printed" on a website (www.arxiv.org) before they have gone through the grinding process of review and revision. This can lead to misunderstandings.

In the case of Sir Martin, the misunderstanding was over who first came up with the idea that the gamma rays in bursts are generated by inverse Compton scattering. In September, he and his colleagues pre-printed a paper on the subject which did not acknowledge the contribution to the field of two researchers called Arnon Dar and Nir Shaviv. This is the sort of omission that peer review is intended to correct, but Dr Dar got in touch anyway, and Sir Martin agreed to make the change in the published version, which is about to come out in a journal called *Monthly Notices of the Royal Astronomical Society*.

Several weeks later, however, another researcher named Alvaro De Rújula, who works with Dr Dar, posted a paper on the same website, pointing out the omission in what many might regard as immoderate language. Sir Martin revised the pre-printed version. But the incident raises questions, and not just about possible libels.

On the face of things, pre-printing is a good idea. It exposes a paper to wider scrutiny than the old system did, which should improve its accuracy—as happened in this case. But it also suggests that the price of getting one's ideas into the public domain rapidly is a need to keep them continuously revised in order to avoid criticism, however moderately or immoderately expressed. Like the Red Queen, in "Through the looking glass", today's physicists need to rush faster and faster merely to stay in the same place.

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About sponsorship

Israel and Palestine

A senseless spiral

Nov 13th 2003
From The Economist print edition

AFP

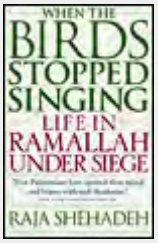
Two writers—one Israeli, one Palestinian—dwell on the war that no one can resolve

IT'S the noise, writes David Grossman, the gunshots, sirens, incendiary clichés, the frantic ringing of telephones: a cacophony, he believes, that saves Israelis and Palestinians from the silence that might otherwise tell them that they are squandering their lives in a pointless struggle that should have been resolved long ago. As he tries to hear the bulbuls' song on a soft spring day, Raja Shehadeh is also deafened by the crash of Israeli tanks, the empty Arab rhetoric on television, the telephone ringing on and on. Here are two gentle, civilised men, both longing to be left alone to write fiction, forced into opposite sides of a vile conflict.

Mr Shehadeh chronicles day-to-day life in Ramallah in April 2002, the month that the city, along with other West Bank towns, was invaded and occupied by the Israeli army in retaliation for the Passover bombing in Netanya. A Palestinian who has fought hard for human rights, Mr Shehadeh now devotes himself to writing and his legal practice. His account is not of horrors, though terrible news from elsewhere trickles through, but of the humiliation of an ordinary sensitive person suddenly faced with the fact that his town, his life and his home are no longer his to enjoy, but are at the mercy of an army that “does not recognise [Palestinian] humanity”.

With its tanks filling the twisty streets “like elephants taking a stroll in one's back garden”, the army took over his brother's house, herding the children at gun point. Fearing his house would be next, Mr Shehadeh made everything as clean and neat as could be, praying that the soldiers would not mess up his precious files. In fact, the soldiers behaved decently when they broke into his house a few months later. Others were not so lucky: he recounts nasty tales of wilful vandalism, from the destruction of records and equipment to dumping the water out of a fishbowl (leaving an empty sardine tin in the bowl with instructions to feed the fish).

When the Birds Stopped Singing: Life in Ramallah Under Siege
By Raja Shehadeh



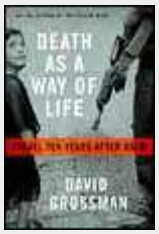
Steerforth Press; 160 pages; $12.95

Buy it at
Amazon.com
Amazon.co.uk

Death as a Way of Life: Israel Ten Years After Oslo
By David Grossman

Wanting to behave normally, Mr Shehadeh resents the narrow priorities imposed on him and his neighbours by the curfew. Breaks in the curfew meant that “they appeared as fellow prisoners let out for a brief exercise in the prison yard.” Life was reduced to food: buying, hoarding and eating. It could all have been much worse, but Mr Shehadeh excels in the unexaggerated honesty of his thoughts.

The people in most danger, he notes, were the young security men, given guns by the Palestinian Authority but then abandoned, left to their own devices with no instructions and no protection. As armed men, they were the Israeli army's target, and they had nowhere to hide. But what sort of political and security authorities, Mr Shehadeh angrily asks, leave their people stranded like this? There seemed, he writes “to be a Palestinian strategy neither for war nor for peace.”



Farrar, Straus and Giroux; 192 pages; $22. Bloomsbury; £8.99

Buy it at
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Not much Israeli strategy either, suggests Mr Grossman in his elegant collection of articles and essays. The pieces, mainly written for newspapers in Israel, Europe and America, cover particularly turbulent moments in the ten years from the signing of the Oslo accords in September 1993 to the second anniversary of the second *intifada* in September 2002, from a pinnacle of hope to cavernous despair.

Mr Grossman despairs at the changes he sees in his fellow Israelis, their comatose voting for leaders who make peace impossible, their inability to recognise Palestinian claims “lest the justice of our own cause be appropriated from us”. Mid-way through the ten-year period, he writes: “Within an astoundingly short time our young, friendly, bold country has undergone mental processes of accelerated ageing [turning] rigid, suspicious, dejected...” He briefly celebrates the election of Ehud Barak, followed all too soon by the collapsed negotiations, the boomerang of the second *intifada*, and Ariel Sharon's “seduction of the Israeli public”.

“These are repulsive times,” he writes, “in which good sense has been reduced to a zombie-like stupor.” He blames the Palestinian leaders too. “Sharon and Arafat have together, in a collaboration that makes the skin crawl, complicated politics to the point where it has turned to war.” But his painful, eloquent bitterness is reserved for what has happened to Israel.

Like Mr Shehadeh, Mr Grossman thinks in prison terms. Towards each other, Israelis display the hostility “of prisoners sharing a cell”. He pleads passionately for international intervention, but in vain. Meanwhile, Israelis and Palestinians remain incarcerated in a noisome prison, echoing with its calls for revenge; the key, it seems, has been thrown away.

When the Birds Stopped Singing: Life in Ramallah Under Siege.
By Raja Shehadeh.
Steerforth Press; 160 pages; $12.95

Death as a Way of Life: Israel Ten Years After Oslo.
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British prisons

Rambo's lament

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GOOD prisons, reformed prisoners, dedicated prison officers, one honest head of the prison service and a couple of decent prison ministers: all existed in the five years up to July 2001 when Sir David Ramsbotham was the chief inspector of prisons for England, Wales and Northern Ireland, and all receive his tribute in this account of his experiences. But they were the exceptions. The bulk of what this former army officer found in the course of his 237 inspections was simply shameful.

Prisongate: The Shocking State of Britain's Prisons and the Need for Visionary Change
By David Ramsbotham

Free Press; 272 pages; £20

Buy it at Amazon.co.uk

Inevitably, the horror stories stand out: the women who have to attend antenatal clinics in chains; the “cells little better than lavatories”; the 18-year-old sex offender housed on the same prison landing as the man who had sexually abused him when he was five; the 50% of children in one institution who were released without knowing where they would spend their first night of freedom; the prisoner who, having threatened staff, was held for 206 days with no access to work, education, hobbies, the gym, the chapel or even a radio, on the say-so of the director of high-security prisons alone. Tales of bullying, vindictiveness and inhumanity abound.

In some ways, though, the most depressing vignettes are the less eye-catching ones. Here is an example. Clinical studies in many countries, reports Sir David, have proved that correct nutrition is a cheap, humane and highly effective way of reducing anti-social behaviour. This was proved yet again in a trial conducted with over 400 young offenders at an institution in Aylesbury. Half were given a daily supplement to their diet containing vitamins, minerals and fatty acids, and the other half a placebo. Over the time of the trial, there was a 37% reduction in serious offences such as violence in the group taking the supplement. “The Home Office response was to insist that its nominated expert should examine the result. He reported that the data were 92% statistically pure, an almost unheard of score. However...both Home Office and Prison Service remain obdurately opposed to accepting the results or adopting the process more widely”—though the cost would be a mere £3.5m ($5.9m) a year from a budget of £2.8 billion.

Over and over again, Sir David lays the blame for the miserable performance of the Prison Service not so much on those at the bottom of the hierarchy as on those at the top—the area managers, their superiors, the top civil servants and, not least, the ministers. These are the people who have read, or should have read, report after report, study after study, all showing that you cannot cut reoffending rates, let alone suicides, if you cram more and more prisoners into understaffed jails designed (often 100 years or more ago) to hold a fraction of their present number and, more fundamentally, if you refuse to treat prisoners as human beings. The upshot is hugely overcrowded prisons which allow fewer and fewer opportunities for education, exercise or any other purposeful activity—the absolute prerequisite for any kind of rehabilitation and thus for the claim that “prison works”.

If only it did. The prison population, says Sir David, consists of the bad, the mad and the sad. With 70% of male prisoners suffering from some form of personality disorder and 65% having a reading age of less than eight, it is clear that the mad and the sad constitute the main categories. It is equally clear that the only regime on offer in most British jails—best described as malign neglect—serves them particularly poorly. Yet politicians, both Tory and Labour, clamour to lock up even more offenders who pose little threat to the public.

Michael Howard, home secretary when Sir David started his job and now leader of the Conservative Party, got the trend going. Not only did he make the claim that “prison works”, he overturned the policy

of previous Conservative governments that the deprivation of liberty involved in a prison sentence was punishment enough in itself. Mr Howard said he disagreed—in other words, that it was right for the Prison Service to add to a prisoner's punishment through punitive regimes. None of his successors has dared to look less tough. Accordingly, the Home Office expects the prison population to rise to between 91,400 and 109,600 by the end of the decade, compared with 44,566 ten years ago. Since the cost of one new prison place is now £100,000, the policy is sure to involve even more overcrowding, neglect, degrading treatment—and crime.

It would be nice to think that books like Sir David's might help avert this dismal outcome. All past evidence suggests, however, that ministers will simply try to cover up their failures by imposing meaningless targets and league tables based on procedures, not results. And it is a racing certainty that they will not appoint as chief inspector another person, let alone a general so outspoken in the face of the waste, pointlessness and inhumanity that seem to come with the job. Too bad—not least because the Prison Service has lots to learn from the army, which knows how to turn immature young men into useful citizens, by building their self-confidence through education, training and respect.

Prisongate: The Shocking State of Britain's Prisons and the Need for Visionary Change.
By David Ramsbotham.
Free Press; 272 pages; £20

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David Sylvester

The eyes have it

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ALTHOUGH celebrated for his art criticism and his interviews with Francis Bacon and other artists, the late David Sylvester (1924-2001) began his writing career as a cricket correspondent for the *Observer*. It was, he said, “the most testing literary exercise I have undergone”. But it proved invaluable, for the qualities that make a good cricket commentator—a sense of timing and acute observation, a passion for elegant ritual and the psychology mixed with physicality of a sport that is baffling to outsiders—all contributed to making Sylvester one of the greatest art critics of his time. This posthumous collection of his writings and interviews provides a valuable opportunity to re-examine his talent for observing the long game of art.

London Recordings
By David Sylvester

Chatto & Windus; 210 pages; £22

Buy it at
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The book displays in full Sylvester's catholic interests. There is an interview with Diaghilev's friend, the Russian-born Leonide Massine, and also a conversation with Sir Harrison Birtwistle, a British composer whose son Adam was one of many artists to paint Sylvester's portrait. It includes Sylvester's catalogue essay, as well as an interview, for an exhibition he curated of the film designs of his school friend Ken Adam, creator of Dr Strangelove's war room and of James Bond sets. There are encounters with visual artists both old (William Coldstream, Henry Moore) and new (Rachel Whiteread, Douglas Gordon). The collection is by no means comprehensive—there are none of the famous Bacon interviews here—and would have benefited from more entries, illustrations and a stronger introduction to the man and his work. But it makes up for this with myriad insights into the creative life. In one interview, for example, Howard Hodgkin says, “for an artist time can always be regained, wonders never cease because by any act of imagination, you can always go back.”

Perhaps the most touching interview is his last, a few months before his death. In it, he asks Mike Brearley, a retired cricketer, now a psychoanalyst and art enthusiast, about the similarities between greatness in sport and in art. Mr Brearley replies that both share a sense of the uncompromising, of “not turning one's face away”.

In a way, this is also an attribute of a great critic. Sylvester was steadfast in his gaze. The descendant of rabbis, he was unreligious, reserving his awe for art and his Old Testament wrath for anyone who transgressed it. He spoke only when he had something to say and was sacked as a radio critic for what became known as the “Sylvester pause”, his long silences which punctuated conversations. Yet the hypnotic drone of his voice could coax the most revealing admissions from artists—not about their personal lives, a topic he considered frivolous—but about the mystery of how they made their work, of creation itself. He had a Socratic gift for dialogue, eliciting from artists ideas that had never occurred to them before; unlike Socrates, however, he didn't prove his interlocutor wrong at the end. It is clear from these interviews that both parties made discoveries. So will anyone who reads this intelligent and elegant book.

London Recordings.
By David Sylvester.
Chatto & Windus; 210 pages; £22

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European history

Better luck next century

Nov 13th 2003
From The Economist print edition

Europe Reborn: A History, 1914-2000
By Harold James

Pearson Education; 512 pages; £15.99

Buy it at
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WRITING European history is a difficult business. The geography is so elastic. Do you stop at the Urals? What about Turkey? Recent history is particularly complicated. It is hard to make sense of such a profusion of facts, ideas and people. Did totalitarian ideas flourish in Europe chiefly because of the demonic genius of Hitler and Lenin? Or because of the rapid and painful way the pre-1914 world collapsed?

And then there is the tricky business of periods and dates. When did the last century really begin, and really end? Was the second world war over once Nazi Germany was defeated in 1945; or did it fizzle on, in reality, until the final crushing of military resistance to Communist rule in the 1950s; or was the war really over only in 1991 when the Yalta settlement blessedly unravelled, and the continent reunited?

Harold James, an eminent Princeton historian, deals expertly with Europe's past century, with particular emphasis on underlying trends. He concludes that the old ideas of left-right politics and nation-states are giving way to a more integrated and consensual future, with sovereignty stitched together in an untidy patchwork quilt. Secular values of democracy, free markets and state-provided welfare have replaced those of feudalism and the papacy, but Europeans from the era of Christendom and the Holy Roman Empire would find today's arrangements comfortingly familiar, he argues.

For newcomers, the boxes will be particularly useful. Pioneered by Norman Davies, in his unparalleled single-volume history of Europe, these break up the author's elegant narrative with succinct accounts of the main political ideas (mostly bad) generated on the European continent in the past hundred years. Confused about the differences between Marxism, Leninism, Trotskyism and Stalinism? Look no further. Each is neatly explained in about a page. So are more recherché ideas, like Existentialism. A concluding box, on “isms and wasms” is a gem.

Whereas Mr Davies highlighted the neglected bits of Europe's past, Mr James refreshes the familiar. Ambitiously, his book continues until 2000. This is not history as seen from a well-mounted telescope; more as glimpsed in a rear-view mirror.

Making sense of the past century, while retelling its story, requires a deft mixture of explanation and description. A good example of Mr James's craft is a brief but cogent analysis of the neutral countries during the second world war: Spain and Portugal, with fascist governments, helped the Nazis much less than democratic Sweden and Switzerland, who found their precarious geography far outweighed their distaste for Hitler.

But fitting several dozen countries into one book is a squeeze, and sometimes Mr James skates rather lightly over interesting and complex topics. Inter-war Greece, for example, merits only a slender paragraph. The post-1991 account of the former Soviet Union reads more like a cuttings job than real history. Like medieval Muscovy, post-Communist Russia seems a lot stranger and nastier than the rest of Europe. Summarising the shenanigans of tycoons and politicians exemplifies that, but does not explain it.

Mr James rightly avoids one catch-all thesis. Explaining European history as a search for modernity is as misleading as blaming modernity for the continent's problems. But progress, economic and political, is a subtle theme of the book. Europe ended the century more happy, free and prosperous than would have seemed imaginable at almost any time since 1914.

He notes firmly, though, that all efforts to force the pace of progress have failed. Neither Stalin's Russia nor Hitler's Germany delivered anything like the economic benefits that their apologists claimed. The best and most lasting improvement in human conditions, he suggests, comes in countries where change is gradual and consensual. Britain is one. Europe's tragedy is that so few other countries have had the chance to try such a gentle approach; his concluding exhortation, softly implied, is “better luck next century”.

Europe Reborn: A History, 1914-2000.
By Harold James.
Pearson Education; 512 pages; £15.99

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About sponsorship

Native Americans

The price of intercourse

Nov 13th 2003
From The Economist print edition

THE beneficiaries of the Ponzi scheme that is at the centre of Brett Fromson's book, “Hitting the Jackpot”, were a small group of people who, with little historical evidence, managed to claim the mantle of an obscure Indian tribe and then through clever legal manoeuvres, gain the right to a gambling monopoly in New England. Only in America, you might well think.

The story begins with the defeat of the Pequot tribe at the hands of settlers in the 1600s. Over the years, both the tribe and the beautiful 2,000-acre reservation they were given in eastern Connecticut steadily contracted, so that by the time Eliza Plouffe, the last resident died in 1973, only 200 acres of land remained.

After failing to run a snack bar successfully or become a preacher, Plouffe's grandson, the one-sixteenth Pequot Skip Hayward, decided to reclaim his Indian heritage. America in the 1980s was becoming increasingly eager to right past wrongs, so Mr Hayward's well-timed efforts hit the jackpot. A group of federally funded anti-poverty lawyers turned up the “non-intercourse act”, an old law signed by none other than George Washington himself that prohibited the sale of any land by Indians without explicit federal approval, and began looking to apply it.

Hitting the Jackpot: The Inside Story of the Richest Indian Tribe in History
By Brett Fromson

Atlantic Monthly Press; 244 pages; $24

Buy it at
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Amazon.co.uk

The contraction of the Pequot reservation, which largely occurred in the mid-1800s, was deemed to have occurred without federal endorsement. In short order, these attorneys found a client in Mr Hayward, who, along with his “tribe”, a list he put together of relatives, found themselves with a claim not only on the property used by his grandmother but neighbouring properties too.

With this as a lever, Mr Hayward and his lawyers convinced the federal government to buy out the surrounding property owners, authorise the Pequots as a genuine tribe and provide them with lots of aid money as well. Opponents of the scheme included the Department of the Interior and the Reagan administration, but anyone who challenged Mr Hayward's claim to a tribe was quickly excoriated by other politicians for being insensitive or uninformed.

Within a decade, Mr Hayward and his legal team—who by now had become his financial advisers—found enough gaps in state, federal and Indian law, and enough co-operative government officials, to permit the Pequots the unique right to offer casino gambling in New England. By 1993 the Pequots owned the largest casino in the world, with annual revenues soon exceeding $1 billion.

Even this, though, was not enough. The tribe's talents did not, unfortunately, extend to areas in which they did not have an advantage in law. Their conventional businesses, which included a gravel pit, a pizza restaurant and a lettuce farm, were all disasters. About $250m was spent building a museum.

Anyone with the flimsiest claim to Pequot ancestry was included to swell the tribal numbers. The resulting Pequot population quickly grew to more than 600 people who were united by nothing more than the lure of casino profits. Unsurprisingly, social problems abounded. Some turned to violence and petty crime. Meanwhile, in the late 1990s another tribe with a slightly better location were also awarded a gambling licence, thus undermining the Pequots' monopoly. Mr Fromson says his book is about the richest tribe in American history, but as he shows, there are some things that money just can't buy—even for the rich.

Hitting the Jackpot: The Inside Story of the Richest Indian Tribe in History.

By Brett Fromson.
Atlantic Monthly Press; 244 pages; $24

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About sponsorship

Philosophy lessons

Head jam

Nov 13th 2003
From The Economist print edition

What philosophers really have to say about “The Matrix”

Reuters

His dark materials

WHEN the first film in the Wachowski brothers' “Matrix” trilogy came out in 1999, academic philosophers everywhere were cock-a-hoop. Not because they had a hitherto unrecognised fondness for shiny black costumes, balletic mayhem, or Keanu Reeves, the film's permanently baffled but pretty protagonist. They were pleased because it provided a wildly popular bandwagon for them to jump on.

For over a quarter of a century, philosophers had been talking about “brains in vats”—the idea that all our experiences might be delusions produced by electronic stimulations of the brain. “The Matrix” brilliantly dramatised this thought-experiment with its premise that most people spend their lives in oversized test-tubes, their “reality” a collective hallucination created by computer programs. In the cinema at least, the hallucination has been a lucrative one. The three films have taken over $1 billion at the box office, according to their distributor, Warner Brothers, and hundreds of millions of dollars more in videos, DVDs and games. At last, it seemed, philosophers were somehow relevant.

Courses were soon designed around “The Matrix”, books were published with titles like “The Matrix and Philosophy”, and the trilogy's official website posted articles by eminent (and not-so-eminent) academics on “Plato's Cave and The Matrix”, and suchlike. But now the philosophers are ready to slink away again. The final film of the trilogy, “The Matrix Revolutions”, which opened around the world last week, was greeted with universal disdain by the critics. Box-office takings in America for its opening weekend were 45% down compared with the opening weekend of the second instalment, “The Matrix Reloaded”, in May, and that had pretty awful reviews too.

Perhaps it is time for the philosophers to come clean. Most of them never really liked the brains-in-vats idea in the first place. In fact the main thrust of most post-war Anglo-American philosophy—rightly or wrongly—is that the notion is incoherent. Ever since Wittgenstein, philosophers have argued that mental experience is essentially public and objective in a way that makes it hard to make sense of the internalised reality that is portrayed in “The Matrix”. Philosophers have largely raised the question of brains in vats in order to dismiss it without another look.

The first extended discussion of the idea, by Hilary Putnam of Harvard University, in 1981, sought to prove that “I am a brain in a vat” is a type of self-defeating utterance, which can never be true. This is (roughly) because terms like “brain” and “vat” could not carry their usual meanings for someone who was cut off—in the way that “The Matrix” supposes—from the everyday objects to which the terms purportedly refer. Somebody might, in theory, have the misfortune of having his brain artificially stimulated without any normal connection to the external world. But he or she would not have the language to state or even think that this was so. And thus, according to Professor Putnam, they cannot intelligibly suppose that it is so either.

A related train of thought is implied by the work of Donald Davidson, who was, until his death in August, probably the most discussed of living American philosophers. Davidson argued, ingeniously, that our basic beliefs about the world cannot be wrong through and through because otherwise we would have no reason to regard them as genuine beliefs. In other words, Davidson maintained that it is literally impossible to fool all of the people all of the time. For film directors, though, there is plainly no harm in

trying.

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Richard Neustadt

Nov 13th 2003
From The Economist print edition

Getty

Richard Neustadt, adviser to presidents, died on October 31st, aged 84

THE year was 1952, with Dwight Eisenhower about to trounce Adlai Stevenson, and Harry Truman, the Oval Office incumbent, was in bitter mood. “He'll sit here,” he said, drumming his fingers on the desk, “and he'll say, ‘Do this!' ‘Do that!' *And nothing will happen*. Poor Ike—it won't be a bit like the army.”

Had he himself done any better? Alas, no. “I sit here all day trying to persuade people to do the things they ought to have sense enough to do without my persuading them...That's all the powers of the president amount to.”

In 1960, as Richard Neustadt wrote his classic textbook, “Presidential Power”, he took these remarks to heart. He was no longer at Truman's side, having become a professor of government at Columbia University in New York. Yet he realised his advice was needed in the White House, and gave it, unvarnished, whenever a president asked. If, as he once said, he had become “infected with politics in Mr Truman's school”, he had also deeply imbibed his frustrations. Much of his life was spent trying to analyse and soothe them.

When Mr Neustadt's career began, just after the second world war, presidential power was seen in a very different way. Years of sycophancy and political theorising had convinced incoming presidents that they wielded near-total authority. Victory in the war had given them something close to universal sway, in the free world at least. Yet their power, in Mr Neustadt's devastating phrase, amounted in fact to a “clerkship”. They could not force or order change. Instead, they more or less had to seek it from Congress “on their knees”.

In what, then, did their authority consist? Three things, said Mr Neustadt: public prestige, professional reputation, and most of all the power to persuade. The three were linked. If the public liked a president, Congress (assuming, as so often, that it was of the other party) would go along for a while, granting him a brief honeymoon. The slightest sign of unease in the country, however, would remove the smiling mask, and Congress would pounce to destroy him. The answer, therefore, was not to act like a campaigner or a commander, but to be conciliatory. A new president had to learn that power in America was wielded most effectively by the separated branches acting together. He had to get Congress on his side, and concentrate on going where his opponents might be willing to follow. That way lay the prospect of impressive shows of power.

Mr Neustadt's two great examples were Roosevelt's New Deal of the 1930s, when bipartisanship was

forged out of national despair, and Ronald Reagan's first hundred days, when unity sprang from a common urge to cut taxes. In general, though, he found the “hundred days” idea pernicious. Although it helped hugely, as he told John Kennedy, to kick off a presidency with energy and achievement, it was all too easy for new men to fall foul of their own naivety and arrogance. Presidents too often tried to do the biggest things first, when they were least experienced.

An uphill task

Mr Neustadt became increasingly fascinated by presidential transitions: those odd weeks, between election and inauguration, when aims are set and agendas formed. He warned Kennedy to prioritise ruthlessly, to “postpone what is postponable” and to set up working groups right away with a “bird-dog” in charge to keep them focused. He advised against appointing cabinet secretaries too early, lest they wander off-message on their own, and reminded the president that everything he said would now be taken very seriously. Much the same advice went to Bill Clinton in his transition in 1992; but little that Mr Neustadt told his friend seemed to be taken to heart. Mr Clinton's health-care plan was a prime example of trying, with maximum hubris and a tangle of competing working groups, to force legislation through the teeth of Congress.

In his long career Mr Neustadt advised Republicans, too, but his heart was always firmly Democratic. His father had worked for Roosevelt on the Social Security Board, and the house of his childhood buzzed with New Deal talk. He himself cut his teeth in lowly posts in Roosevelt's administration and in Truman's budget office. For all his understanding of the limits of power, he liked his governments activist.

He was not, however, drawn to active politics for long. From 1954 he preferred to lecture on the sidelines, first at Columbia, then at Harvard, where he helped set up the Kennedy School of Government and was a founding director of its Institute of Politics. For two decades, wreathed in smoke from an evil pipe, he taught Government 154 there, while his treatise on presidential power went through several revised editions.

At his feet, for a while, sat the young Al Gore. His subject was English, but Mr Neustadt was responsible for turning him to politics. Like many other students, he was also welcomed into Mr Neustadt's house, where he played the favourite game, charades, with a wit and versatility his teacher never saw again. Mr Neustadt, who also advised Michael Dukakis, was often unlucky in those who heard his words of wisdom. For all his warnings, pre-eminent power, or the hope of it, remained a loud and diverting siren-song.

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Overview

Nov 13th 2003
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The **euro-area** economies may be picking up at last. Germany's GDP rose at an annual rate of 0.9% in the third quarter, after three consecutive quarters of decline. But that still left output 0.2% below its level a year earlier; and industrial production fell by 3.6% in the year to September. Germany's ZEW survey of investor expectations rose to its highest level for 16 months in November, suggesting that growth should be stronger in the fourth quarter. France's GDP expanded by an annual rate of 1.6% in the third quarter.

America's non-farm payrolls increased by 126,000 in October. Not only was this a bigger increase than expected, but the figures were also revised to show stronger jobs growth in August and September. The unemployment rate fell to 6% of the labour force, down from a peak of 6.4% in June.

Unemployment in **Britain** rose by 12,000 in the three months to September; the jobless rate held steady at 5.0% of the labour force. In October, **Switzerland's** jobless rate rose to a five-year high of 3.8%.

Gold jumped to a seven-and-a-half-year high of $397 per ounce in New York trading. The **dollar** weakened again this week, slipping to ¥108.60 and to $1.165 against the euro. It also touched a new ten-year low against the Canadian dollar and a six-year low against the Australian dollar.

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Output, demand and jobs

Nov 13th 2003
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2003	2004	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 2.0	Q2	+ 0.5	+ 2.6	+ 3.7	+ 1.3	Q2	+ 5.3	Q3	5.6	Oct	6.0
Austria	+ 0.7	Q2	+ 1.1	+ 0.7	+ 1.8	+ 5.4	Feb	– 4.0	Aug	4.5	Sep	4.3
Belgium	+ 0.8	Q2	– 0.4	+ 0.9	+ 1.8	– 2.9	Sep	– 3.6	Aug	12.9	Oct†	11.9
Britain	+ 1.9	Q3	+ 2.3	+ 2.0	+ 2.7	– 1.0	Sep	+ 3.9	Sep	5.0	Sep††	5.3
Canada	+ 1.6	Q2	– 0.3	+ 2.0	+ 3.0	+ 1.5	Jul	+ 3.7	Aug	7.6	Oct	7.6
Denmark	– 1.0	Q2	– 2.2	+ 0.8	+ 2.0	+ 0.5	Sep	+ 3.4	Aug	6.3	Sep	5.3
France	– 0.1	Q3	+ 1.6	+ 0.2	+ 1.7	– 1.8	Sep	– 2.2	May	9.7	Sep	9.1
Germany	– 0.2	Q3	+ 0.9	nil	+ 1.6	– 3.6	Sep	– 3.1	Sep‡	10.5	Oct§	9.9
Italy	+ 0.3	Q2	– 0.3	+ 0.4	+ 1.6	– 1.7	Sep	– 3.4	Aug	8.5	Jul	9.0
Japan	+ 3.0	Q2	+ 3.9	+ 2.6	+ 1.8	+ 4.1	Sep	– 1.8	Sep	5.1	Sep	5.4
Netherlands	– 1.1	Q3	+ 0.4	– 0.6	+ 1.1	– 1.2	Sep	– 3.6	Jul	5.4	Sep**	4.2
Spain	+ 2.3	Q2	+ 2.7	+ 2.2	+ 2.8	+ 2.0	Sep	+ 2.0	Aug	11.2	Sep	11.5
Sweden	+ 1.1	Q2	+ 1.1	+ 1.5	+ 2.3	+ 3.0	Aug	+ 3.8	Sep	4.8	Sep†	4.2
Switzerland	– 1.0	Q2	– 1.2	– 0.5	+ 1.4	– 2.8	Q2	+ 2.7	Sep	3.8	Oct†	2.8
United States	+ 3.3	Q3	+ 7.2	+ 2.8	+ 3.9	nil	Sep	+ 8.3	Sep	6.0	Oct	5.8
Euro area	+ 0.2	Q2	– 0.3	+ 0.4	+ 1.8	+ 0.1	Aug	– 0.9	Aug	8.8	Sep	8.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 0.8	Q2	+ 2.4	na	na	+ 1.4	Sep	+ 5.6	Aug	8.0	Sep†	8.1
Greece	+ 4.5	Q2	+ 0.4	na	na	+ 2.1	Jul	na		na		na
Iceland	+ 2.7	Q2	na	na	na	– 0.3	2002	na		2.7	Sep†	2.2
Ireland	+ 2.1	Q2	na	na	na	– 2.5	Sep	+ 0.4	Aug	4.4	Oct	4.3
Luxembourg	+ 1.1	2002	na	na	na	+ 9.5	Aug	+ 1.2	Jun	3.9	Sep	3.0
New Zealand	+ 2.0	Q2	– 0.5	na	na	+ 2.5	Q2	+ 6.1	Q3	4.4	Q3	5.4
Norway	– 2.0	Q2	– 0.6	na	na	+ 3.7	Sep	+ 5.3	Sep	4.7	Q3	3.8
Portugal	– 2.3	Q2	+ 0.5	na	na	+ 2.3	Sep	– 0.3	Sep	6.2	Q2†	4.5

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡New series. ††Jul-Sep; claimant count rate 3.0% in Sep . §EU harmonised rate 9.3% in Oct. **Jul-Sep.

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Prices and wages

Nov 13th 2003
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2003	2004	latest		year ago	latest		year ago
Australia	+ 2.6	Q3	+ 3.2	+ 2.7	+ 2.3	– 0.1	Q3	– 0.2	+ 5.5	Q2	+ 3.7
Austria	+ 1.4	Sep	+ 1.6	+ 1.3	+ 1.1	+ 2.0	Oct	+ 0.3	+ 2.3	Sep	+ 2.3
Belgium	+ 1.6	Oct	+ 1.3	+ 1.5	+ 1.3	– 1.9	Sep	+ 0.8	+ 1.9	Q3	+ 2.1
Britain	+ 2.8	Sep	+ 1.7	+ 2.7	+ 2.4	+ 1.4	Oct	+ 0.5	+ 3.6	Sep	+ 3.8
Canada	+ 2.2	Sep	+ 2.3	+ 2.7	+ 1.7	– 2.6	Sep	+ 0.6	+ 3.1	Aug	+ 2.7
Denmark	+ 1.4	Oct	+ 2.5	+ 2.2	+ 1.6	– 0.5	Sep	– 0.3	+ 3.8	Q2	+ 3.7
France	+ 2.2	Oct	+ 1.9	+ 2.0	+ 1.5	+ 0.2	Sep	+ 0.3	+ 2.7	Q2	+ 3.9
Germany	+ 1.2	Oct	+ 1.3	+ 1.1	+ 0.9	+ 0.8	Oct	+ 0.9	+ 2.2	Aug	+ 2.9
Italy	+ 2.6	Oct	+ 2.7	+ 2.7	+ 2.1	+ 1.0	Sep	+ 0.9	+ 2.7	Sep	+ 2.1
Japan	– 0.2	Sep	– 0.7	– 0.3	– 0.3	– 0.5	Sep	– 2.0	+ 1.3	Sep	+ 1.4
Netherlands	+ 2.0	Oct	+ 2.9	+ 2.3	+ 1.7	+ 1.1	Sep	+ 1.1	+ 2.3	Oct	+ 3.4
Spain	+ 2.6	Oct	+ 4.0	+ 3.1	+ 2.7	+ 0.8	Sep	+ 1.0	+ 4.2	Q2	+ 4.0
Sweden	+ 1.7	Sep	+ 1.9	+ 2.1	+ 1.7	– 1.5	Sep	– 0.7	+ 3.2	Aug	+ 2.9
Switzerland	+ 0.5	Oct	+ 1.3	+ 0.6	+ 0.5	– 0.4	Sep	– 1.2	+ 1.8	2002	+ 2.5
United States	+ 2.3	Sep	+ 1.5	+ 2.3	+ 1.4	+ 3.5	Sep	– 1.8	+ 2.4	Oct	+ 3.1
Euro area	+ 2.1	Oct	+ 2.3	+ 2.0	+ 1.6	+ 1.1	Sep	+ 0.2	+ 2.9	Q2	+ 3.0
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 0.7	Sep	+ 1.0	na	na	– 0.8	Sep	– 0.8	+ 4.3	Q2	+ 3.9
Greece	+ 3.3	Aug	+ 3.5	na	na	+ 2.2	Aug	+ 2.1	na		na
Iceland	+ 2.5	Nov	+ 2.4	na	na	+ 3.7	Oct	+ 6.2	+ 5.6	Sep	+ 5.8
Ireland	+ 2.9	Sep	+ 4.5	na	na	– 7.8	Sep	– 1.7	+ 8.7	Q2	+ 3.5
Luxembourg	+ 1.7	Oct	+ 2.2	na	na	+ 0.3	Aug	– 0.2	+ 2.2	Aug	– 1.6
New Zealand	+ 1.5	Q3	+ 2.6	na	na	– 2.0	Q2	+ 1.5	+ 2.3	Q3	+ 2.3
Norway	+ 1.6	Oct	+ 1.8	na	na	– 0.5	Sep	– 5.0	+ 5.4	Q2	+ 4.9
Portugal	+ 3.1	Sep	+ 3.7	na	na	– 0.3	Sep	+ 0.1	– 2.1	Sep	+ 0.1

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Austria

Nov 13th 2003
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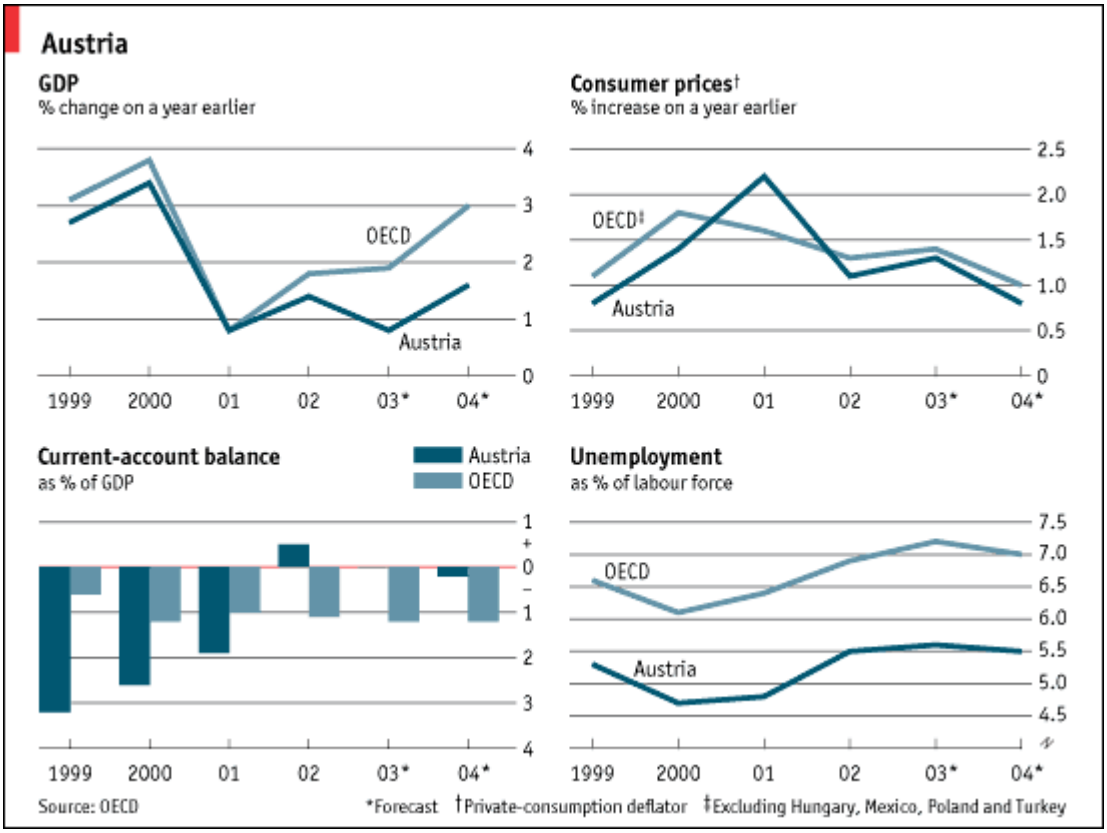

It has long been one of the richest countries in Europe, but Austria's economic performance has fallen below the OECD average in recent years. GDP grew by 1.4% in 2002 and is forecast to grow by only 0.8% in 2003 and 1.6% in 2004, according to the OECD's latest country study. The jobless rate (5.6% in 2003) is still low by OECD standards, but it is high by Austrian standards. With a high ratio of old people relative to the working-age population, Austria faces big challenges. To boost its potential growth rate, the OECD reckons that Austria needs to raise labour-force participation, especially among older workers. It also needs to strengthen public finances and boost productivity growth by opening up sheltered areas of the economy, notably services, to competition. Productivity growth in Austria's service sector has been particularly weak over the past decade.

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Money and interest rates

Nov 13th 2003
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Nov 12th 2003)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 8.8	+12.9	Sep	5.31	4.80	5.60	5.93	5.28	6.66
Britain	+ 7.7	+ 7.4	Sep	3.91	3.94	4.51	5.04	4.49	5.84
Canada	+ 8.5	+ 5.5	Sep	2.73	2.69	3.38	4.98	5.00	6.44
Denmark	+ 5.1	+ 6.2	Sep	2.30	3.35	3.05	4.58	4.54	5.62
Japan	+ 5.6	+ 1.5	Oct	0.02	0.02	0.12	1.37	0.97	1.50
Sweden	+ 3.2	+ 4.9	Sep	2.73	3.94	3.34	4.98	4.88	4.05
Switzerland	+22.3	+ 7.8	Sep	0.27	0.70	0.34	2.80	2.43	2.73
United States	+ 8.1	+ 7.2	Sep	1.30	1.31	2.02	4.41	3.83	6.06
Euro area†	+11.3	+ 7.4	Sep	2.17	3.14	2.80	4.42	4.36	4.38

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 5.21%, Japan No. 255 1.36%. Central bank rates: US fed funds 1.00%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 3.75%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Nov 13th 2003
From The Economist print edition

1995=100

	Nov 4th	Nov 11th*	% change on one month	% change on one year
Dollar index				
All items	86.4	86.9	+ 3.9	+14.6
Food	85.7	87.2	+ 5.1	+ 9.4
Industrials				
All	87.3	86.5	+ 2.2	+22.7
Nfa†	90.1	88.5	+ 0.5	+23.1
Metals	84.9	84.7	+ 3.8	+22.3
Sterling index				
All items	81.2	82.3	+ 4.0	+ 9.3
Euro index				
All items	98.8	99.2	+ 5.5	+ 0.5
Yen index				
All items	100.6	100.5	+ 3.3	+ 4.6
Gold				
$ per oz	379.75	388.25	+ 3.3	+20.7
West Texas Intermediate				
$ per barrel	28.85	31.13	– 1.9	+20.0

* Provisional. † Non-food agriculturals.

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Stockmarkets

Nov 13th 2003
From The Economist print edition

Market indices

	Nov 12th	2003 high	2003 low	% change on one week	% change on record high	% change on Dec 31st 2002 in local currency	% change on Dec 31st 2002 in $ terms
Australia (All Ordinaries)	3,217.4	3,310.6	2,673.3	– 1.2	– 6.5	+ 8.1	+37.6
Austria (ATX)	1,433.4	1,448.0	1,120.2	– 0.1	–17.5	+24.6	+38.2
Belgium (Bel 20)	2,187.7	2,203.4	1,426.6	+ 0.7	–40.6	+ 8.0	+19.8
Britain (FTSE 100)	4,371.3	4,376.9	3,287.0	+ 1.6	–36.9	+10.9	+15.5
Canada (Toronto Composite)	7,797.3	7,870.9	6,228.6	– 0.9	–31.5	+17.9	+43.1
Denmark (KBX)	216.2	222.6	145.0	– 1.5	–28.4	+30.0	+44.0
France (SBF 250)	2,334.0	2,358.4	1,630.1	+ 0.5	–46.8	+13.7	+26.0
(CAC 40)	3,411.1	3,453.1	2,403.0	+ 0.5	–50.7	+11.3	+23.4
Germany (DAX)	3,748.3	3,782.6	2,203.0	+ 0.8	–53.5	+29.6	+43.7
Italy (BCI)	1,230.2	1,241.2	959.4	+ 0.4	–43.6	+12.7	+24.9
Japan (Nikkei 225)	10,226.2	11,161.7	7,607.9	– 5.6	–73.7	+19.2	+30.1
(Topix)	1,006.2	1,105.6	770.6	– 5.4	–65.1	+19.3	+30.2
Netherlands (AEX)	336.9	343.0	218.4	+ 0.3	–52.0	+ 4.4	+15.7
Spain (Madrid SE)	768.6	769.6	576.8	+ 0.8	–32.9	+21.2	+34.4
Sweden (Affarsvarlden Gen)	182.8	184.1	127.8	+ 0.9	–54.3	+25.9	+42.4
Switzerland (Swiss Market)	5,270.6	5,422.6	3,675.4	+ 1.3	–37.3	+13.8	+16.7
United States (DJIA)	9,848.8	9,858.5	7,524.1	+ 0.3	–16.0	+18.1	+18.1
(S&P 500)	1,058.6	1,059.0	800.7	+ 0.6	–30.7	+20.3	+20.3
(NASDAQ Comp)	1,973.1	1,976.4	1,271.5	+ 0.7	–60.9	+47.7	+47.7
Europe (FTSE Eurotop 300)*	932.1	941.5	682.7	+ 0.5	–45.3	+ 8.8	+20.6
Euro area (FTSE Ebloc 100)*	800.1	808.8	565.7	+ 0.7	–48.4	+11.4	+23.5
World (MSCI)†	968.2	968.2	710.8	+ 0.4	–33.2	+22.2	+22.2
World bond market (Citigroup)‡	571.4	583.9	518.6	+ 0.9	– 2.1	+ 8.8	+ 8.8

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Nov 13th 2003
From The Economist print edition

	Trade balance*, $bn latest 12 months	Current account $bn latest 12 mths	Current account The Economist poll % of GDP, forecast 2003	Current account The Economist poll % of GDP, forecast 2004	Exchange rate trade-weighted† 1990=100 Nov 12th	Exchange rate trade-weighted† 1990=100 year ago	Currency units per $ Nov 12th	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2003‡
Australia	− 13.5 Sep	− 24.4 Q2	− 5.6	− 4.9	86.4	73.9	1.40	1.79	2.34	1.62	1.28	0.2
Austria	− 0.4 Aug	+ 0.9 Aug	nil	− 0.1	102.6§	100.8	0.86	0.99	1.44	–	0.79	-1.3
Belgium	+ 19.9 Aug	+ 11.2 Jun	+ 4.7	+ 4.8	102.6§	100.0	0.86	0.99	1.44	–	0.79	nil
Britain	− 73.9 Sep	− 28.6 Q2	− 1.7	− 1.5	100.1	106.2	0.60	0.63	–	0.69	0.55	-1.9
Canada	+ 40.7 Aug	+ 14.7 Q2	+ 1.7	+ 1.4	89.2	75.0	1.30	1.58	2.18	1.51	1.20	1.1
Denmark	+ 9.4 Aug	+ 5.9 Aug	+ 2.7	+ 2.7	105.8	103.2	6.39	7.36	10.7	7.44	5.88	1.6
France	+ 5.6 Sep	+ 21.5 Aug	+ 1.4	+ 1.4	106.0§	102.9	0.86	0.99	1.44	–	0.79	-3.6
Germany	+137.2 Sep	+ 56.4 Sep	+ 2.0	+ 2.0	103.5§	99.9	0.86	0.99	1.44	–	0.79	-3.7
Italy	+ 2.5 Aug	− 18.8 Aug	− 0.8	− 0.7	75.6§	73.4	0.86	0.99	1.44	–	0.79	-2.4
Japan	+ 97.7 Sep	+123.3 Sep	+ 2.8	+ 2.9	138.3	133.3	109	120	182	127	–	-7.7
Netherlands	+ 30.4 Aug	+ 15.1 Q2	+ 2.3	+ 2.6	102.1§	99.1	0.86	0.99	1.44	–	0.79	-1.6
Spain	− 49.2 Aug	− 22.4 Jul	− 2.4	− 2.2	76.9§	75.0	0.86	0.99	1.44	–	0.79	-0.4
Sweden	+ 17.1 Sep	+ 11.1 Q2	+ 4.1	+ 4.1	82.3	78.5	7.70	8.98	12.9	8.96	7.08	0.7
Switzerland	+ 6.0 Sep	+ 35.0 Q2	+11.0	+11.0	109.8	114.9	1.35	1.45	2.26	1.57	1.24	na
United States	−537.8 Aug	−528.7 Q2	− 5.1	− 5.3	98.5	112.5	–	–	1.68	1.16	0.92	-4.6
Euro area	+ 82.9 Aug	+ 34.7 Aug	+ 0.4	+ 0.5	89.4	82.6	0.86	0.99	1.44	–	0.79	-2.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 13.7 Sep	+ 10.0 Sep	na	na	81.5§	79.0	0.86	0.99	1.44	–	0.79	3.1
Greece	− 24.3 Aug	− 10.6 Aug	na	na	59.2§	58.0	0.86	0.99	1.44	–	0.79	-1.0
Iceland	− 0.1 Aug	− 0.2 Q2	na	na	95.0**	93.0	75.9	85.4	127	88.3	69.8	nil
Ireland	+ 37.5 Aug	− 2.1 Q2	na	na	94.2§	89.1	0.86	0.99	1.44	–	0.79	-0.8
Luxembourg	− 3.3 Aug	+ 1.5 Q2	na	na	102.6§	100.0	0.86	0.99	1.44	–	0.79	0.2
New Zealand	− 1.7 Sep	− 2.9 Q2	na	na	101.3	89.4	1.60	2.02	2.68	1.86	1.47	0.8
Norway	+ 27.0 Sep	+ 26.7 Jul	na	na	97.5	106.4	7.03	7.26	11.8	8.18	6.46	11.3
Portugal	− 12.9 Aug	− 7.8 Aug	na	na	93.6**	91.3	0.86	0.99	1.44	–	0.79	-3.2

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, September average. ‡OECD forecast. **IMF, July average.

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Exchange-rate forecasts

Nov 13th 2003
From The Economist print edition

Exchange-rate forecasts

From J.P. Morgan Chase, currency units per $

	November 12th	3-month	12-month
Euro area*	1.16	1.22	1.25
Japan	108.7	105.0	98.0
Australia	1.40	1.39	1.47
Britain†	1.68	1.72	1.76
Canada	1.30	1.29	1.29
Denmark	6.39	6.10	5.95
Sweden	7.70	7.10	6.96
Switzerland	1.35	1.26	1.23
China	8.28	8.28	8.17
Singapore	1.73	1.70	1.68
South Korea	1,173	1,100	1,020
Brazil	2.90	3.10	3.25
Mexico	11.1	11.0	11.3
Poland	3.92	3.69	3.44
Russia	29.9	30.3	30.1
South Africa	6.87	7.20	7.80

*$ per € †$ per £

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Overview

Nov 13th 2003
From The Economist print edition

Industrial-production growth is picking up speed in several countries. Output is growing most spectacularly in **China** where production rose by 17.2% in the year to October. It is also increasing at an impressive rate in **Turkey**, with production up by 12.7% in the 12 months to September; in **Malaysia**, up by 9.7% over the same period; and in **India**, up by 6.5%. However, industrial production fell in **South Africa** by 3.6%.

In **Brazil**, consumer-price inflation slackened from 15.1% in the year to September to 14.0% in the year to October. Industrial production, which had previously been falling, rose by 4.2% in the year to September.

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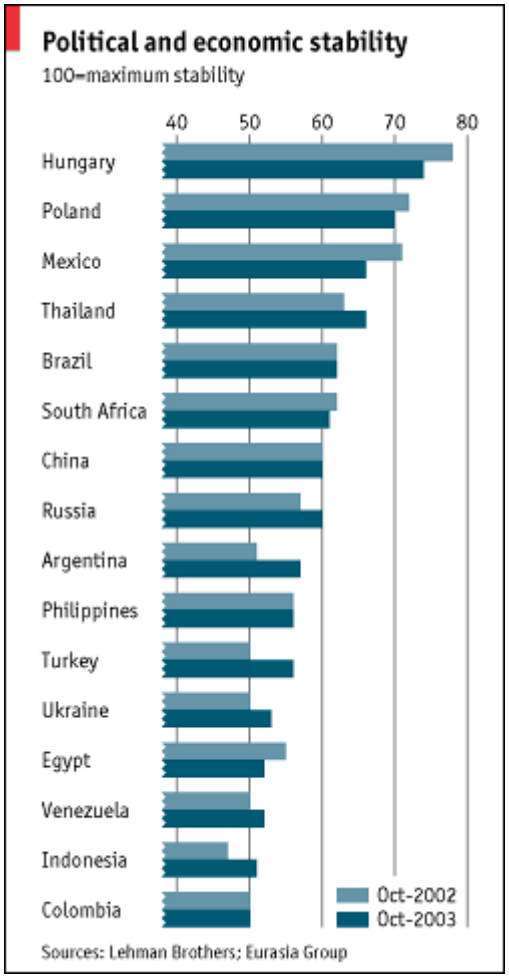
Political and economic stability

Nov 13th 2003
From The Economist print edition

Hungary remains the most stable emerging economy of those monitored by Lehman Brothers and the Eurasia Group, a firm that analyses political risk. According to their political-stability index, which tries to measure a country's ability both to withstand crises and to avoid generating them, Hungary scores 74 out of a possible 100, down from a score of 78 a year ago. Poland comes second with a score of 70 (down from 72). However, several countries, including Thailand, Russia, Argentina, Turkey and Indonesia, are now rated as more stable than they were a year ago.



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Economy

Nov 13th 2003
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.1	Q3	+17.2	Oct	+ 1.8	Oct	+20.6	Oct	+35.4	2002	383.9	Sep
Hong Kong	– 0.5	Q2	–12.5	Q2	– 3.2	Sep	– 6.9	Sep	+18.4	Q2	112.4	Oct
India	+ 5.7	Q2	+ 6.5	Sep	+ 2.9	Sep	–12.4	Sep	+ 2.8	Q2	88.7	Oct
Indonesia	+ 4.1	Q3	+ 4.7	Jul	+ 6.2	Oct	+26.1	Sep	+ 6.7	Q1	32.8	Sep
Malaysia	+ 4.4	Q2	+ 9.7	Sep	+ 1.3	Oct	+17.4	Sep	+10.1	Q2	37.7	Sep
Philippines	+ 3.2	Q2	+ 7.0	Aug	+ 3.1	Oct	– 1.6	Aug	+ 2.8	Jul	13.5	Oct
Singapore	+ 1.0	Q3	+ 6.3	Sep	+ 0.7	Sep	+15.0	Sep	+23.8	Q2	92.5	Oct
South Korea	+ 1.9	Q2	+ 6.6	Sep	+ 3.7	Oct	+12.8	Oct	+ 6.9	Sep	141.5	Sep
Taiwan	– 0.4	Q2	+ 7.5	Sep	– 0.1	Oct	+19.0	Oct	+26.9	Q2	196.6	Oct
Thailand	+ 5.8	Q2	+10.5	Sep	+ 1.2	Oct	+ 4.6	Sep	+ 8.5	Sep	39.3	Sep
Argentina	+ 7.6	Q2	+10.8	Sep	+ 3.9	Oct	+17.3	Sep	+10.2	Q2	13.4	Sep
Brazil	– 1.3	Q2	+ 4.2	Sep	+14.0	Oct	+23.4	Oct	+ 3.6	Sep	47.8	Aug
Chile	+ 2.7	Q2	+ 5.8	Sep	+ 1.2	Oct	+ 2.6	Oct	– 0.8	Q2	15.7	Oct
Colombia	+ 2.0	Q2	– 1.2	Aug	+ 7.1	Sep	– 0.1	Aug	– 1.7	Q2	10.7	Sep
Mexico	+ 0.2	Q2	– 0.6	Sep	+ 4.0	Oct	– 6.4	Sep	–11.5	Q2	52.1	Sep
Peru	+ 3.1	Aug	+ 1.4	Aug	+ 1.3	Oct	+ 0.4	Aug	– 1.2	Q2	9.8	Sep
Venezuela	– 9.4	Q2	–13.6	Aug	+25.6	Oct	+14.6	Q2	+ 9.3	Q2	12.8	Jun
Egypt	+ 3.1	2003†	+ 4.2	2002†	+ 4.5	Aug	– 7.1	Mar	+ 1.9	Q2	13.6	Jun
Israel	– 0.3	Q2	– 0.9	Aug	– 1.9	Sep	– 6.4	Oct	nil	Q2	24.9	Oct
South Africa	+ 1.8	Q2	– 3.6	Sep	+ 3.7	Sep	+ 3.2	Sep	– 0.9	Q2	6.5	Sep
Turkey	+ 3.9	Q2	+12.7	Sep	+20.8	Oct	–19.3	Aug	– 4.7	Aug	33.9	Sep
Czech Republic	+ 2.1	Q2	+ 2.7	Aug	+ 0.4	Oct	– 2.3	Sep	– 5.0	Q2	25.6	Sep
Hungary	+ 2.4	Q2	+ 9.4	Aug	+ 4.9	Oct	– 3.8	Aug	– 5.0	Aug	12.8	Sep
Poland	+ 3.8	Q2	+11.1	Sep	+ 0.9	Sep	–10.1	Sep	– 4.8	Sep	31.6	Sep
Russia	+ 7.2	Q2	+ 8.0	Sep	+13.1	Oct	+55.7	Aug	+38.0	Q3	61.2	Oct
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+ 3.5	Q2	+ 9.7	Sep	+ 1.4	Sep	– 1.8	Sep	– 1.2	Q2	1.2	Jul
Latvia	+ 6.2	Q2	– 0.6	Aug	+ 3.3	Oct	– 1.8	Aug	– 0.9	Aug	1.3	Jul
Lithuania	+ 6.7	Q2	na		– 1.4	Oct	– 2.4	Aug	– 0.9	Q2	2.7	Jul
Slovakia	+ 3.8	Q2	+ 3.9	Sep	+ 9.6	Oct	– 1.2	Sep	+ 1.1	Jul	10.4	Jul
Slovenia	+ 2.1	Q2	+ 3.4	Sep	+ 4.8	Oct	– 0.5	Jul	+ 0.1	Aug	7.8	Jul
Pakistan	+ 5.1	2003†	+ 7.2	Jun	+ 3.5	Oct	– 1.2	Oct	+ 4.0	Q2†	9.9	Sep
Saudi Arabia	+ 1.0	2002	na		– 1.2	Jul	+41.8	2002	+11.7	2002	21.1	Jul

*Excluding gold, except Singapore; IMF definition. †Year ending June.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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Financial markets

Nov 13th 2003
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Nov 12th		Dec 31st 2002	
	Nov 12th	year ago	Nov 12th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	13.9	na	1,377.6	– 4.9	– 2.9	– 2.9
Hong Kong	7.76	7.80	13.0	0.30	11,971.5	– 3.8	+ 28.4	+ 29.0
India	45.3	48.3	75.9	4.94	5,005.8	– 1.2	+ 48.2	+ 56.9
Indonesia	8,478	9,047	14,212	8.75	619.9	– 2.5	+ 45.9	+ 54.0
Malaysia	3.80	3.80	6.37	3.03	790.3	– 2.8	+ 22.3	+ 22.3
Philippines	55.3	53.2	92.7	8.13	1,363.5	– 4.7	+ 33.9	+ 29.2
Singapore	1.73	1.77	2.90	0.78	1,717.4	– 3.4	+ 28.1	+ 28.5
South Korea	1,173	1,202	1,966	4.25	796.3	– 1.1	+ 26.9	+ 28.3
Taiwan	34.0	34.5	56.9	1.05	5,982.8	– 2.6	+ 34.4	+ 37.6
Thailand	40.0	43.3	67.0	1.37	653.5	– 3.0	+ 83.3	+ 97.6
Argentina	2.85	3.53	4.78	4.88	924.4	– 4.3	+ 76.1	+107.7
Brazil	2.90	3.66	4.86	18.85	18,793.5	+ 2.7	+ 66.8	+103.5
Chile	626	709	1,049	2.76	7,148.0	– 0.2	+ 42.4	+ 64.0
Colombia	2,853	2,722	4,782	7.91	2,190.3	+ 0.1	+ 36.2	+ 36.8
Mexico	11.1	10.3	18.6	7.56	8,539.3	+ 3.7	+ 39.4	+ 31.5
Peru	3.48	3.60	5.83	2.52	2,109.6	+ 0.2	+ 51.6	+ 53.2
Venezuela	1,598	1,357	2,679	18.07	21,311.7	– 4.6	+165.9	+130.7
Egypt	6.15	4.64	10.30	6.89	11,029.0	– 0.4	+105.3	+ 54.7
Israel	4.52	4.69	7.58	2.63	494.7	+ 0.3	+ 48.8	+ 56.3
South Africa	6.87	9.80	11.5	8.20	9,827.3	+ 0.4	+ 5.9	+ 32.2
Turkey	1,481,466	1,628,000	2,483,381	25.00	15,771.4	– 3.9	+ 52.1	+ 70.4
Czech Republic	27.4	30.4	46.0	2.07	630.0	– 2.2	+ 36.7	+ 50.0
Hungary	222	237	372	9.97	9,807.5	+ 0.9	+ 25.8	+ 27.5
Poland	3.92	3.95	6.57	5.66	20,401.7	nil	+ 42.0	+ 39.0
Russia	29.9	31.8	50.0	16.00	519.6‡	– 3.9	+ 44.7	+ 35.2
EMF (MSCI)*	1.00	1.00	1.68	na	412.5	– 1.2	+ 41.2	+ 41.2
EMBI+†	1.00	1.00	1.68	na	284.2	+ 0.3	+ 24.2	+ 24.2

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡ In $ terms.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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